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"Nam neque quies gentium sine armis, neque  
arma sine stipendiis, neque stipandia sine  
tributis haberi queunt. Cetera in communi  
vita sunt."

Caius Cornelius Tacitus

Ab Excessu Divi Augusti Historiae.

Liber IV, Caput 74.

## T I T L E

### INEQUITIES AND INADEQUACIES OF LOCAL TAXATION.

Principles and Practice in Unitary  
and Federal Countries with Special  
Reference to Great Britain and the  
United States.

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## P R E F A C E

The present study is an attempt both to analyse and illustrate the financial and economic implications of the intergovernmental relations in unitary and federal polities. The investigation is confined to the baneful or conflicting impact of the various interrelationships.

The Prologue clarifies certain basic notions and trends and summarizes the writer's views. Part One on Inequities, deals, in the first chapter, with fiscal inequities and inequalities and in the second chapter, with overlapping and multiple taxation.

Part Two on Inadequacies, is composed of two chapters. The first tackles the tax revenue deficiencies of the junior authorities. The second chapter expounds the conflicts which are prone to arise between local and national financial policies.

Part Three on Intergovernmental Fiscal Co-ordination, is also an epilogue. It sets out diverse means of inter-local and notably central-local financial co-ordination. Various proposals are made.

The writer owes an invaluable debt to Doctor Mary Rankin, Reader in Economics in Edinburgh University, for her precious guidance, suggestions and encouragement which made this thesis possible.

Saad Maher Hamza.

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Intermediate Authority: the authorities between the national government and the lowest localities.

Secondary Authority, Tertiary Authority: purposes to larger and smaller units respectively.

Local Authority: the following terms denote, in a general way, all subdivisions of a country, whether unitary or federal, unless otherwise specified or easily understood:

Local unit, local area, locality, junior authority, minor authority, underlying authority, subordinate unit of government, lower layer or tier of government.

Co-locality: a local unit of the same category within the same country.

# TERMINOLOGY.

National Government, Central Government and Supreme Authority

all designate the top authority.

State: this term is generally avoided in the sense of country.

It is preferably confined to the intermediate authorities in certain federal polities, for instance, the U.S.A. and Australia.

Province: the counterpart of "state" in other federations, such as Canada.

Overlying Authority: any upper authority. Sometimes denotes the central government.

Major Authority: a larger unit within the same country, for example, province or state.

Intermediate Authority: the authorities between the national government and the lowest localities.

Secondary Authority, Tertiary Authority: purpose to larger and smaller units respectively.

Local Authority: the following terms denote, in a general way, all subdivisions of a country, whether unitary or federal, unless otherwise specified or easily understood:

Local unit, local area, locality, junior authority, minor authority, underlying authority, subordinate unit of government, lower layer or tier of government.

Co-locality: a local unit of the same category within the same country.

Intra-Local: within the same local unit, confined to it.

Inter-local: inter-area (or inter-areal): between the local units per se.

Central-local, National-local: between the central government and the subordinate units.

Intergovernmental: between the various levels of authorities within the same country.

Monotaxing Authority: a local unit having the power to impose only one type of tax.

Pluritaxing Authority: a local unit having the power to levy several taxes.

Monotaxing Capacity, Pluritaxing Capacity: the fiscal capacity of resorting to one or several imposts.

Under-endowed, Under-privileged Area or Locality: a local unit with low per capita wealth and income and hence a low fiscal potential.

Cosmopolitan Income, Inter-local Income, sometimes Pan-locality Income: income, personal or corporate, originating in several local units.

Extra-local Income: income originating outside the local unit.

Domestic Income: income arising within the local unit.

Income Partition: the splitting out or parcelling out of income due to separate taxation by type of income or by different minor authorities.

Upper, High (or low)-Income recipient, income receiver, income earner, income group, income bracket: these terms are preferred to rich (or poor) people.

## PREFACE

### The Central-Local Allocation

### Financial Powers

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## PROLOGUE

### The Central-Local Allocation

### Financial Powers

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## I. UNITARY COUNTRIES.

In the Middle Ages, the various regions and boroughs were the entities with inherent powers rather than delegated. Various historical, political and socio-economic factors are responsible for the apportionment of financial powers between senior and junior authorities within the same national boundaries. The fiscal intergovernmental relations vary from country to country, and within the same country, change from time to time.

A brief sketch is given, in this prologue, of the main patterns of financial inter-relationships and the centripetal forces at work. The various concomitant problems are succinctly set out.

# I. UNITARY COUNTRIES.

In the Middle Ages, the various regions and boroughs were separate entities with inherent powers rather than delegated powers. The State was more of a superstructure above the local governments. In fact, civil rights, individual social and economic standing were derived from membership in the local association of public law, such as the county, borough, corporation or guild.

Furthermore, the lack of transport facilities, the primitive stage of the economy and other factors militated in favour of autonomous regions and city-states. A foreigner was one belonging to another borough.

Nations came into being gradually. The fights waged with powerful neighbours, the improvement in communications, the marked progress achieved in the cultural and economic domains fostered nation-formation.

Thus the minor governments had many of their responsibilities integrated in the national polity. However, they resisted the "subordination" to the "centre" in sundry fields. The local communities were not bent on relinquishing various "rights" of which they were so jealous. They strove to stem metropolitan interference and to manage their own



affairs in such matters as taxation, expenditure, the regulation of domestic industries and trade and the discharge of sundry ancillary services.

The strife between overlying and underlying authorities thus ushered in varying patterns of local finances responding to the amount of control secured by each tier. In some cases, the minor authorities enjoyed a substantial share of home rule. In other cases, the central government was successful in wielding overwhelming power "for the sake of national unity."

England enjoyed much local government responsibility thanks to the smooth development of its political institutions. Conversely, France has a long tradition of central government which attained its apex, during the Ancien Régime, under Louis XV, and was pursued by the Great Revolution whose ideal was to make France "une et indivisible."

The apportionment of financial and economic powers between major and minor governments has little significance under conditions of primitive economy or laissez-faire. However, as soon as economics become a prominent preoccupation of individuals and/or authorities, the implications of intergovernmental political and fiscal relations acquire crucial importance.

Apart from federal countries, discussed below, it is possible to distinguish "strong local government democracies" where local finances would constitute at least one third of

total finances, "weak local government democracies" where local finances would not exceed one fifth of total finances<sup>(1)</sup> and "totalitarian states" where local responsibility disappears actually or virtually.

Strong local government democracy is a feature of Anglo-Saxon and Scandinavian traditions. It involves the right of the local voters to elect their local officers through whom they control their own affairs and adapt central government laws to the conditions of the local community. In fact, in "Local Self-Government", the local councils are not subordinate to the executive to the same extent as in "Local State Government".<sup>(2)</sup>

England affords a good illustration of local self-government. The local elections need no confirmation by the central government which, moreover, cannot dissolve the local bodies as often occurs in other countries. The local councils are presided over by elected persons. In consequence, there is a substantial degree of responsibility reflected in the

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- (1) Hicks, U.K. : "The Grant Provisions of the Local Government Bill".  
Bulletin of the Oxford University Institute of Statistics. February, 1948. pp.33-34. London, 1950.
- (2) Harris, Montagu : "Comparative Local Government".  
London, 1948.

(3) Nissenmann, "Centralisation et Décentralisation", Paris, 1948.

financial field. The local bodies frame their budgets, on both revenue and expenditure sides with comparatively more freedom and relatively less control from the centre.<sup>(1)</sup>

In the second category of weak local government, various degrees of deconcentration are noticeable with corresponding patterns of central-local fiscal interrelationships. The latter have a point in common, namely the absence of local initiative owing to the subjection of the local councils to an executive, in sum the hegemony of the metropolis. These conditions justify, in French terminology, the use of the definition "déconcentration" as opposed to "décentralisation".<sup>(2)</sup>

The French practice of the prefectorial system provides considerable instruction in connection with weak local government. The Prefect is a nominee of the government of the day and his office is political. In consequence, he is the local agent of the supreme authority and the "tuteur" of the department. As such, he is expected to enforce central policy. The prefect wields wide powers, dominates the local

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- (1) Local Government in Europe. Edited by Anderson, William. New York, 1939.  
On England, see also:  
Finer, Herman : "English Local Government". London, 1950.  
Robson, William A. : "The Development of Local Government". London, 1948.  
Smellie, K.B. : "A History of Local Government". London, 1946.
- (2) Eisenmann, William : "Centralisation et Décentralisation". Paris, 1948.

councils and can even suspend them thus reducing them to mere advisory bodies. Local budgets are subject to the approval of the prefect, or his deputy, who may insert certain items of expenditure required by law (i.e. inscriptions d'office) and can have extra taxes imposed.<sup>(1)</sup>

Extreme centralization is a characteristic of totalitarian regimes and rigidly planned economies. In Fascist Italy, the "consulta", or local councils were under the direct control of the Podestà. The latter was both communal administrator and officer of the government and assumed complete administrative and legislative responsibility. The members of the local bodies were centrally-appointed and their activities centrally-controlled. In fact, Fascism implied a denial of the elective principle, the preponderance of the corporative principle, in brief, the hegemony of Rome personified by "Il Duce".<sup>(2)</sup>

Similarly, National Socialism in Germany did not admit of the juxtaposition of local and central authorities. The leadership principle implied concentration of all responsibility in the executive head of the local unit. The Burgomaster was

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(1) Lainville, Robert : "Le Budget Communal". Paris, 1950.  
Chapman, Brian : "Introduction to French Local Government". London, 1953.

(2) Anderson, William : op. cit.  
 "Italy", contributed by Steiner, H. Arthur. pp.307-337.



thus a nominee answerable to the national government. The party delegates in all regions and localities were a further manifestation of ultra-unification.<sup>(1)</sup>

In the U.S.S.R., the various local soviets; Rayon, Oblast, Krai, cities, are merely organs of the State apparatus and sheer instruments of the national planning machinery.

large or geographically dispersed. Illustrations are afforded by Canada, comprising French-speaking Roman catholic elements, the U.S.A., with their large size and distinct southern interests and Switzerland which embraces diverse peoples. The federal structure suits better such territorially detached countries as Indonesia and the West Indies.

In post-war conditions, federalism assumed increasing importance. It was given a strong impetus by various political, military and economic considerations.<sup>(1)</sup>

There are numerous instances of federations recently formed, in gestation or in perspective, generally by integration rather than by disintegration.<sup>(2)</sup>

In Europe, there are federations of Western Germany and

(1) Anderson, William : op. cit. *et al.* in its application to "Germany", contributed by Marx, F. Morstein. pp.273-276.

(2) Instances of federations by disintegration are the U.S.S.R., the Union of India and Brazil.

## II. FEDERAL COUNTRIES.

Federalism is a desirable form of government for communities which exhibit pronounced differences in race, religion or language or simply when the area involved is large or geographically dispersed. Illustrations are afforded by Canada, comprising French-speaking Roman catholic elements, the U.S.A., with their large size and distinct southern interests and Switzerland which embraces diverse peoples. The federal structure suits better such territorially detached countries as Indonesia and the West Indies.

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In Europe, there are <sup>the</sup> federations of Western Germany and

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- (1) Beloff, Max : "The Federal Solution in its Application to Europe, Asia and Africa". Political Studies. June, 1953. p.114.
- (2) Instances of federations by disintegration are the U.S.S.R., the Union of India and Brazil.

Yugoslavia. The attempts for the economic or military integration of Western European countries are conducive to political integration. The Schuman Plan, which transferred certain sovereign rights to the supra-national High Authority in respect of coal and steel, may be a step nearer European Federation.<sup>(1)</sup> The European Defence Community, if ratified by the countries concerned, paves the way to economic and political integration. The Benelux agreement and the suggested Franco-Italian customs union militate in favour of the same desideratum.

In Asia, the federal form is exemplified by the new constitutions of India,<sup>(2)</sup> Burma and Pakistan.

From time to time, the question of federating the Arab countries is raised. Integration may, some day, take shape.

In Africa, there are Lybia and the Central African Federation. The federal form is also envisaged for Nigeria

(1) Aron, Raymond : "Problems of European Integration".  
Lloyds Bank Review. April, 1953. p.1.  
Also - "La Federation des Six". Figaro, 3 and 4  
Decembre, 1952.  
Reuter, Paul : "La Conception du Pouvoir Politique  
dans le Plan Schuman".  
Revue Francaise de Science Politique. July-Sept. 1951.

(2) Ghosal, A.K. : "Federalism in The Indian Constitution".  
The Indian Journal of Political Science. Oct-Dec.1953. p.317  
Banerjea, B.N. : "Le Fédéralisme dans la Constitution  
Indienne".  
Revue Francaise de Science Politique. July-Sept. 1951.



and East Africa. constitution apportions the financial powers

In South America, it is noticeable that Brazil reverted to the federal form in 1946 after the strong centripetal impact of President Vargas' policy. and regional taxing

The British Caribbean colonies provide a further illustration of prospective federation.<sup>(1)</sup> with the sensitisation

It may also be mentioned that some colonial powers advocate federation with their dependencies, for instance France and its North African territories, notably Morocco.

In a federal polity, sovereignty is divided between the major and minor governments. The latter are not hierarchical in their relations inter se, but have a special status and enjoy wide powers guaranteed by a rigid constitution. In fact, the federal principle, as defined by Professor Wheare, is "The Method of dividing powers so that the general and regional governments are each, within a sphere, co-ordinate and independent."<sup>(2)</sup> number of taxing jurisdictions operate

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(1) Bailey, Sidney : "Une Federation des Caraibes Britanniques". *Revue Francaise de Science Politique*. July-September, 1952.  
 Birch, A.H. : "A British Caribbean Federation: The Next Dominion?" *Parliamentary Affairs*. No.1 - 1950.

(2) Wheare, K.C. : "Federal Government." 1951. p.11.  
 It is noteworthy that a federal country may be, in practice, a quasi-federation (e.g. Weimar Republic, Republican Indian Constitution of 1950) or a nominal federation (U.S.S.R., Argentina, Mexico, Venezuela).

(1) Shultz, W.J. : "American Public Finance and Taxation", 1st ed. p.250.

The federal constitution apportions the financial powers between overlying and underlying authorities. Some of these powers are exclusively federal, some exclusively regional and some others are shared between federal and regional taxing jurisdictions. A first pattern specifies the powers of the federal government and leaves the residue with the constituent states, as in the U.S.A. and Australia. In the U.S.A., the states can be said to have inherent powers, the federal government designated powers and the towns and villages delegated powers.<sup>(1)</sup> A second pattern assigns particular powers to the individual members and vests the residue in the federal government as in Canada. In practice, however, both modes of allocation amount to the same result; namely that the junior governments in a federal polity have a more free-hand, in the economic field, than in unitary countries.

In federalism, two constitutional systems and a subsequent great number of taxing jurisdictions operate fiscalwise upon the nation's resources. Consequently, the problem of national-local fiscal relations assumes special importance. The minor governments, being pluritaxing, can levy not only property taxes but also income taxes, business taxes, death taxes and consumption taxes, whether specific or general. The para-central borrowing powers are wide. The

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(1) Shultz, W.J. : "American Public Finance and Taxation".  
1st ed. p.250.

conditions attached to the grants are more liberal and slack than in unitary countries.

Federalism is, therefore, pregnant with consequences from the viewpoint of financial interrelationships. The problems ushered in are more intricate than in unitary countries. The wild conglomeration of tax laws on the lower level is conducive to sundry intra-local, inter-local and central-local fiscal inequities and inequalities. The co-existence of multiplex and competing taxing jurisdictions inevitably leads to horizontal and vertical overlapping and duplicate taxation. Furthermore, the regional fiscal powers may have distortionary resource allocative effects. The minor governments' taxing, borrowing and spending powers may be wielded in such wise as to counteract, or even nullify, national economic policies. National compensatory fiscal policies can be defeated through anachronistic application of local spending powers. Federalism magnifies the divergent or disruptive impact of the junior authorities not acting in unison either inter se or with the national government.

Various guarantees are sometimes provided by the federal constitutions against such incompatibilities. In the U.S.A., there are the Due Process of Law Clause, the Welfare Rule, the principle of Intergovernmental Tax Immunity.<sup>(1)</sup> These

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(1) Groves, Harold : "Financing Government". New York, 1947. p.408.  
Selko, Daniel : "The Federal Financial System". Washington, 1940.

provisions, however, fail to cope with the complete<sup>de</sup> fiscal implications of federalism, especially in its orthodox or classical form.

On the other hand, the central government, in unitary countries, is the single sovereign body. It wields untrammelled financial powers, has no "defect of constitutional authority" and cannot be accused of "invading" the local financial field. The underlying authorities have a restricted field of action (being sometimes only monotaxing as in England) and exhibit less fiscal diversities. Consequently, there is less room for intergovernmental inequities or overlapping. Similarly, horizontal and vertical economic disharmony is less marked. as a result of the "reeducational" policy of the allies. (1)

On the other hand, however, local government may not only develop together with national government along un-democratic lines, but the former may continue as an anti-democratic, or even anti-democratic force; whilst the national government has already evolved into a truly representative and essentially democratic regime. (2)

(1) Gillen, J.F.J. : "State and Local Government in West Germany, 1945-53" (with special reference to U.S. Zone and Bremen). 1953.

Ziebill, Otto : "The German Towns' Council and the Municipal Economic Activity". In Annals of Collective Economy. January-March, 1954. p.41.

(2) Langer, Georges : "Local Government and Democracy", in Public Administration (Journal of the Institute of Public Administration). Spring 1953. p.27.



### III. LOCAL GOVERNMENT AND DEMOCRACY.

There is no necessary parallelism between local government and democracy. True, local government and central government may develop simultaneously along democratic lines. Furthermore, in some countries the autocracy of the central government may cause local institutions to develop as an anti-absolutist reaction thus acquiring a genuine democratic character. This occurred in Europe to resist anti-constitutional monarchies and is illustrated by post-war Germany as a result of the "reeducational" policy of the Allies.<sup>(1)</sup>

On the other hand, however, local government may not only develop together with national government along un-democratic lines, but the former may continue as an a-democratic, or even anti-democratic force; whilst the national government has already evolved into a truly representative and essentially democratic regime.<sup>(2)</sup>

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(1) Gillen, J.F.J. : "State and Local Government in West Germany, 1945-53" (With special Reference to U.S. Zone and Bremen). 1953.

Ziebill, Otto : "The German Towns' Council and the Municipal Economic Activity". in Annals of Collective Economy. January-March, 1953. p.41.

(2) Langrod, Georges : "Local Government and Democracy", in Public Administration (Journal of the Institute of Public Administration). Spring 1953. p.27.

The divorce between local government and democracy can be illustrated by Austria-Hungary between 1866 and 1918 when local bodies were a stronghold of anachronistic prerogatives.

At the present time, in the Middle East, local councils are a replica of the absolutist governments on the central level. Local elections, as well as general elections, are only a facade. The membership of the local councils is based upon material criteria and the councillors are drawn from the class of high income-receivers especially the potent local landowners. The chairman of the local bodies is generally a nominee of the central government, often the administrator of the local area. The local pseudo-elective bodies, being subordinate to an agent of the central government, enforce the policy of the latter. In other terms, the oligarchy on the higher administrative level is duplicated and reinforced by a further oligarchy on the lower level.

In the writer's view, the existence of aristocratic institutions at the local level, is not only an impediment to an all-nation democratic polity, but is also pregnant with economic and financial implications involving a further violation of the democratic principle. The concept of democracy does not solely purport to political freedom, it imports economic freedom as well. A socio-political disequilibrium, at one or more government layer, generates corresponding economic disequilibria at the same level or other



strata. If the junior authorities are undemocratic, they will impede, through divergent action, the social and redistributive financial policies implemented by a national democratic administration. Similarly, the local undemocratic authorities tend to foster the reactionary economic policies of an undemocratic central government.

In fact, "totalitarian" local governments can, through their taxing, borrowing and spending powers, enhance the maldistribution of wealth and income and can widen the cleavage between the different social strata.

On the taxation side, the regressive structure of local taxation may be made even more regressive and eventually the progression of the national tax system as a whole may be vitiated. This is especially liable to occur in classical regionalism and orthodox federalism, where territorial fiscal powers are wide, or when, in under-developed countries, the minor authorities make extensive use of property taxation, the latter being an important element of the fiscal system. The same distorting impact on progressiveness easily manifests itself when central taxation carries only mildly graduated rates as was often the case before the Second World War in both unitary and federal countries.

On the expenditure side, the minor governments may pursue "aggravative", instead of redistributive, policies imputing social welfare to the high-income groups rather than, or

relatively more, than, the low-income classes. Furthermore, national full employment policies may be frustrated by divergent or ill-timed local spending policies.

To sum up, local government is not necessarily a "school of civics" or a "nursery of good statesmen". It can be just the reverse.

Consequently, it is most important to democratic<sup>be</sup> local administrative and financial institutions, especially in authoritarian or oligarchic polities, as a first step towards an all-inclusive democracy in its full acceptance of political as well as socio-economic equity.

Within the framework of central-local fiscal relations, economic democracy implies security and general welfare for all members of the society in their capacity of national citizens as well as local residents. In their latter capacity, similar citizens, who reside in diverse local areas, have the right to enjoy the same degree of well-being or fiscal treatment (i.e. taxation cum expenditures) irrespective of local availabilities.

The financial version of the liberal economy can be put in a nutshell, "limited and balanced budgets". Public

#### IV. CENTRIPETAL FORCES.

The evolution, in socio-economic theory, from individualism towards interventionism and economic planning, carries important implications from the viewpoint of central-local fiscal relations. The impact is threefold; quantitative, qualitative and allocative.

The central tenet of classical economy is that full employment for labour and other resources is secured through the free play of market forces. Supply creates its own demand so that a deficiency in aggregate demand is not possible. The flexibility of interest rates achieves the equality of saving and investment, and the flexibility of prices and wages guarantees the absorption of all factors of production by private enterprise. Unemployment can thus be only frictional.

In sum, the normal situation, under classical assumptions, is stable equilibrium at full employment. The best thing the authorities could do, to guarantee full employment was to abstain from disturbing the market forces, in other terms, "laissez-faire".

The financial version of the liberal economy can be put in a nutshell, "limited and balanced budgets". Public

expenditures encroach on private savings and impair investment. Taxation must avoid savings so as not to militate against the accumulation of capital. It must let, undisturbed, the "equilibrating forces" of the market, and leave, unaffected the relative financial positions of the tax-payers. Consequently, taxation must hit consumption rather than income, and assume a proportional structure rather than a progressive scaling.

Borrowing, solely for productive purposes, must assume small proportions, otherwise investment is reduced proportionately. Public debt, a real burden, has to be cancelled as soon as possible through taxation of current consumption.

These economic and financial postulates of the individualistic economy involved limited responsibilities for all layers of government, and consequently implied a wider scope for autonomy of the junior authorities.

Gradually, however, various dynamic forces, both endogenous and exogenous, induced government intervention in the economic and social fields. The "spontaneous equilibrium" through the price mechanism was found to be strewn with obstacles and accompanied with much hardship. Full employment is not the normal position towards which the community tends. Saving and investment can be equal at less than full employment level. In fact, saving is a function of income



and the propensity to consume. Investment depends on the marginal efficiency of capital and the monetary rate of interest. Moreover, prices and wages are no more elastic and cannot be relied upon to bring about the absorption of all the labour forces. Full employment can be only achieved if the total volume of effective demand, private and public, on both consumption and investment, is kept at a high level. Since the consumption function is stable in the short run, the authorities have the duty to intervene, through fiscal policy, to generate the appropriate volume of effective demand to achieve full employment.

The "Welfare State" does not only aim at high employment levels but also at high living standards and provision of social services.

As for the exogenous factors, wars had the most far-reaching centralising impact.

The driving forces, which caused the "Liberal State" to evolve into a "Welfare State", brought about a further stage, namely the "Planning State".<sup>(1)</sup> Economic planning, of various nuances and purposes,<sup>(2)</sup> involve the mobilisation of the

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(1) For a review of the driving forces see:  
Zweig, Ferdynand : The Planning of Free Societies.  
 London, 1942. pp.37-56.

(2) The nuances range from simple "programmation" to "dirigism", and the purposes from social ends to sheer megalomania. See Hamza, S. Maher : Planification et Investissement des Capitaux en Egypte. M.Sc.(econ.) Cairo University.



nation's resources and the rationalization of its economy. The fact that the national economy becomes subject to central control reduces the junior authorities to the role of sheer satellites turning in the orbit of the senior government.

To sum up, interventionism and economic planning, whether flexible or rigid, exert a twofold effect on national-local finances. They generate an expansion, combined with a refinement, of fiscal powers. They also set off centripetal forces difficult to counter. These forces are traceable in unitary and federal countries alike.

#### 1. Unitary Countries.

The centralist tread is affecting various forms. The traditional local areas grow larger and larger through consolidation, co-ordination or co-operation.<sup>(1)</sup> The local fiscal powers are gradually rising to successively higher levels. The proportion of central financial aid in local budgets is increasing and the accompanying conditions are becoming stricter.

Similarly, the various functions and services performed by junior authorities are in process of integration either

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(1) On the inadequate size of local areas and its economic and financial implications, see the present study, Part Two, Chapter III, "Revenue Inadequacy", Section I "Local Economic Vulnerability".

through direct transfer to overlying authorities or through closer central supervision. In sum, the role played by local elective bodies is weakening.

It is desirable to refer to a specific country to illustrate the centripetal forces at work in unitary countries.

In England, since 1933, various local services were gradually controlled or taken over by the national government, or were subject to various forms of inter-area co-ordination such as the Joint Committee System. The following Acts are expressive of the drive towards the "centre"; The Unemployment Act in 1934, The Trunk Roads Act, 1936, The Fire Brigades Act, 1938.

The development of the area of charge for poor relief is interesting to follow and is significant; from parish to unions of parishes to counties and county borough councils and finally the national government.

In the war-time and post-war periods, the gravitational movement was imparted a fresh impulse. One can only enumerate the series of Acts voted since World War II.<sup>(1)</sup> The Education

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- (1) For an outline survey of the centripetal tendencies in Great Britain, especially during an after World War II, see: Robson, William A. : "Labour and Local Government", in The Political Quarterly. January-March, 1953. p.39.  
 Hill, L.C. : "Local Government in England: Changes and Challenges". Social Research, June, 1950. p.332.  
 Hill, Frank : "Local Government and the State", in The Fortnightly. July-December, 1949. p.315.  
 Hawsworth, J.M. : "Some Developments in Local Government, 1944-1948". Public Administration. Spring, 1948. p.262.  
 Crouch, Winston W. : "Trends in British Local Government". Public Administration Review. Autumn, 1947. p.254.

Act of 1944 transferred some local functions to counties and county boroughs. The Trunk Roads Act, in 1946, made the Minister of Transport responsible for thousands of miles of main highways, and empowered him to bring, by order, any road under his control. All hospitals owned by local authorities were transferred to the Ministry of Health in 1946. The British Transport Commission was authorized, by the Transport Act of 1947, to set up regional schemes. The Fire Services Act, 1947, transferred the brigades to counties and county boroughs. Two main municipal amenities, electricity and gas, which were a concern of local bodies, became a national responsibility through The Electricity Act in 1947 and The Gas Act in 1948. Poor relief followed the same path in 1948 when The National Assistance Act was passed. The Local Government Act, 1948, is important as it vested assessment and valuation for rating in the Inland Revenue.<sup>(1)</sup>

A further aspect of the rising influence of Westminster is the increasingly important role played by grants-in-aid.

In England and Wales, the grants increased both in

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(1) There are also, however, different currents. Instances are; The Civic Restaurants Act, 1947, The Town and Country Planning Act, 1947, The National Parks and Access to the Countryside Act, 1949. It is noticeable that the policy of the Conservative Government is rather centrifugal. See; Brooke, Henry : "Conservatives and Local Government", in; The Political Quarterly. April-June, 1953. p.181.

absolute amount and proportionately to total local expenditures. While in 1913-14 they amounted to £22.5 millions and accounted for 24 per cent of local expenditures, they reached, in 1947-48, £244.5 millions or 45 per cent of local expenditures. In 1950-51 they were £304.1 millions or 50 per cent of total local government income.

## 2. Federal Countries.

In modern conditions, the federal countries, more than the unitary countries, feel the impact of the divorce between the static organisation of government and the dynamic conditions of the economy. In fact, there is in process, both an economic expansion and an economic integration induced by new socio-economic nation-wide objectives. The economic integration calls for an administrative integration which would bring the political structure more in harmony with the new economic structure. The traditional concept of federalism whereby "the general and regional governments are each, within a sphere, co-ordinate and independent"<sup>(1)</sup> needs revisions within the present socio-economic framework.

The co-existence of independent regional fiscal powers and completely exclusive functions is not only difficult to maintain but has become an anomaly. The wide financial powers

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(1) Wheare, K.C. : op. cit. p.11.



left to the states and provinces, when the federal constitutions were first enacted a long time ago, do not only cause distortions to the concept of fiscal equity in its various aspects but are also conducive to intergovernmental fiscal conflicts. Cohesive national economic policy-framing is thus impeded. The minor governments can no more retain exclusive powers, especially if these powers are vital for the conduct of the national economy on rational lines.

In other terms, the constitutional apportionment of federal-regional fiscal powers must be made compatible with the new socio-economic responsibilities thrown on the shoulders of modern national governments.

The contemporary phase of federal development is "co-operative federalism". The real issue is not financial independence versus autonomy but financial co-ordination.

It is noteworthy that while the old federations are in process of integration, the new federal structures are following unorthodox constitutional and economic lines. In sum, federalism is acquiring new significance in financial terms. The writer fully agrees with Professor G.L. Wood that, "Under the economic conditions of the 20th century, much the same forces which prompted agreements among separate States to federate are now impelling federations towards unification."<sup>(1)</sup>

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(1) Wood, G.L. : "The Future of Federal Aid", in; The Economic Record. December, 1945. p.197.



The centripetal tendencies presently at work find expression in both new and established federations. When forming new federations, mostly by integration rather than by disintegration, much heed is now given to the requirements of coherent national economic development and economic stabilization. More powers are thus assigned to the federal government in respect of both taxing powers, notably income taxation, and spending powers.

In already established federations the centripetal forces manifest themselves in two ways, namely; the different spirit of interpretation of the federal constitution and/or the actual federal invasion of the regional economic, financial and social powers.

As for the first point, the principle of Federal Supremacy is given prominence wherever possible notably in respect of powers not exclusively vested in any particular layer of government. In Canada, the Judicial Committee of the Privy Council declares, in 1932, that, "The two taxations, Dominion and Provincial, can stand side by side without interfering with each other, but as soon as you come to the concomitant privileges of absolute priority they cannot stand side by side and must clash; consequently the Dominion must prevail."

A similar shift in the spirit of constitutional

New York, 1951. pp.44-53.

interpretation can be traced in the U.S.A.,<sup>(1)</sup> Australia and Switzerland.<sup>(2)</sup>

The centralizing tendencies, in connection with socio-economic functions generally, may be exemplified by the U.S.A. where occurred a great increase in federal responsibilities either by extension of existing functions or by addition of new functions. The following fields may be noted in this connection; promotion of agriculture, conservation of national resources, public works whether developmental or counter-cyclical, public utility enterprise, regulation and promotion of business, housing whether by direct construction or loans to local authorities, credit and insurance, regulation of labour conditions, specialised education, social security such as unemployment compensation, old-age insurance, public assistance and public health programs.<sup>(3)</sup>

It is possible to distinguish fields where activities are purely federal and others <sup>where</sup> ~~whether~~ there are concurrent federal

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- (1) Fellman, David : "Ten Years of The Supreme Court: 1937-1947, I. Federalism." The American Political Science Review. Dec. 1947. p.1142.
- (2) Rappard, W.E. : "De La Centralisation en Suisse". Revue Francaise de Science Politique. January-June, 1951. p.133.  
However, tradition, geographical and language barriers act as a curb to the centralist tread in Switzerland.
- (3) Benson, George C.S. : "The New Centralization". New York, 1941. pp.44-53.

state and/or local powers. *excluding local grants and shared*

Instances of purely federal activities are agricultural credit (the Farm Credit Administration, the Commodity Credit Corporation, the Surplus Commodities Corporation) and the old-age and survivors' annuity program. *used an increased*

In many other respects, however, there is co-operation, in varying degrees, between federal, intermediate and lower authorities. The Public Works Administration activities involve important contractual and co-operative arrangements with the states and the local authorities. Housing, a new function, and road building are carried out thanks to subsidies provided to the secondary and tertiary authorities. Inter-state communications, regional development schemes, e.g. T.V.A., require central-local co-ordination. The National Resources Planning Board works in close co-operation with the state planning agencies. The bank-deposit insurance program involves co-operation between the Federal Deposit Insurance Commission and the state banking agencies. Social security occupies an important place in connection with concurrent powers, Although education is a state function, the Federal Government shows increasing interest in agricultural and vocational education. *Government Expenditures Since 1950. Review. May, 1953. p.827.*

(2) The current centripetalism in the U.S.A. may be further illustrated by the upward move in state-local relations.

In 1902, local government expenditures were 7 times as

large as state expenditures excluding local grants and shared taxes. In 1942, local expenditures were only 1.7 times state expenditures;

"Not only did direct state expenditures increase more rapidly than local, but states financed an increased proportion of local expenditures through grants and shared taxes - 28 per cent in 1942 as against 6 per cent in 1902."<sup>(1)</sup>

We may now turn to another federation.

In Australia, from 1939 onwards, strong centripetal trends were brought about by several factors, chiefly war and the expansive policy of the Labour Government.

While the expansion in state activities consisted mainly in the intensification of older functions such as education, health, transport and justice, the Commonwealth activities developed along new or largely new lines;

"From thirteen departments in 1939, the number of Federal Departments increased to 25 at the peak of war-time activities."<sup>(2)</sup>

Apart from temporary functions, the following fields may

(1) Fitch, Lyle C. : "Trends in Federal, State and Local Government Expenditures Since 1890." *American Economic Review*. May, 1953. p.227.

(2) Foxcraft, E.J.B. : "Changing Balance of Government in Australia." *Journal of the Institute of Public Administration, Australian Regional Group*. No.4 (New Series). Dec. 1946. pp.184-192.



be noted: coal, education, employment, exports, industrial welfare, information, fisheries, health and social services, housing, mining and mineral resources, primary industry, public works, regional planning, secondary industries, the shipping and shipbuilding, transport and rail unification.<sup>(1)</sup>

While there was Federal assumption of some functions,<sup>(2)</sup> there was Federal-state co-operation in others, e.g., land settlement, health, housing, education.

The minor governments were further bound to the chariot wheels of the federal governments through the increasing role assumed by federal subsidization. Federal aids aim either at compensating the states or provinces for the loss, to the centre, of certain sources of revenue (e.g. Australia, Canada) or aim at fulfilling nation-wide socio-economic objectives. The latter guiding principle is gaining more and more weight.

In the U.S.A., the proportion of federal subventions to net state and local expenditures oscillated, during the period 1920-33 between 1.3% and 3.3%. During 1934-42, the proportion oscillated between 20% and 40%.<sup>(3)</sup>

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(1) Davis, Solomon Rufus : Federal-State Co-operation in Australia. PH.D.(Econ.) London University, 1950. pp.422-430.

(2) In September 1946, social insurance, health services and family allowances were federalized.

(3) See Part Three, Chapter VI.



The general centripetal forces presently under way in federations can be more appreciated by special reference to taxing and borrowing powers.

While the First World War induced the trespass of the federal authorities on various regional tax fields, the Second World War caused effective or virtual federal tax monopolization. In fact, an important repercussion of wars, in federal-regional financial relations, is the tremendous expansion of federal expenditures, while, simultaneously, the productivity of indirect taxation, traditionally reserved to the federal governments, is adversely affected. The latter are thus inevitably led to invade the domain of direct taxation exploited, up till then, by the various territories.

In the U.S.A., the federal progressive income tax rates have become so high since 1938 as to raise an economic barrier against this extensive use on the state level.<sup>(1)</sup>

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- (1) For analysis of this limitation to local income taxation see the present study; Part Two, Chapter III, "Revenue Inadequacy", Section II, "Limitations to Local Taxation."

For development of the centripetal tendencies in the U.S.A., see: Committee on Intergovernmental Fiscal Relations in; "Federal, State and Local Government Fiscal Relations", Senate Document No.69, 78th Congress, 1st Session. Washington, 1943.

Graves, W. Brooke : "The Future of the American States." in American Political Science Review, Feb. 1936.

Haig, R. Murray : "The Co-ordination of Federal and State Tax Systems", in, Proceedings of the National Tax Association, 1932.

In Canada, during World War II, the provincial income taxes were raised to the Dominion level.<sup>(1)</sup>

Similarly, in Australia, the state income taxing powers were appropriated by the Commonwealth Government.<sup>(2)</sup>

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- (1) Rowat, D.C. : "Recent Developments in Canadian Federalism" The Canadian Journal of Economics and Political Science. February, 1952. pp.1-16.

Birch, A.H. : "Federalism and Finance." The Manchester School, May, 1949. p.164.

Eggleston, Wilfrid : "Dominion-Provincial Relations", in: The Annals of the American Academy of Political and Social Science. September, 1947. (Features of Present-Day Canada).

Maxwell, James A. : "Recent Intergovernmental Fiscal Relations in Australia and Canada", in: The Bulletin of the National Tax Association, February, 1945.

Maxwell, James A. : "Canadian Dominion-Provincial Relations" in, Quarterly Journal of Economics, August, 1941.

Report of the Royal Commission on Dominion-Provincial Relations: Book I; Canada, 1867-1939.

- (2) "Taxing Powers in a Federation. A Study of Australian Experience", in: The Round Table, September, 1953. p.319.

La Nauze, J.A. : "The Chariot Wheels of the Central Government". The Economic Record. 1952. p.237.

Greenwood, Gordon : "The Future of Australian Federalism." Melbourne, 1946.

Wood, G.L. : "The Future of Federal Aid." The Economic Record. December, 1945. p.197.

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(1) See Part One, Chapter I, Section IV.

The death taxes were, before World War I, an exclusive right of the states and provinces. In the inter-war period, they incurred the federal invasion. Instances are afforded by Australia and notably the U.S.A. where the American Federal Government encroached upon the field in 1916 and substantially increased the rates in the thirties (1932, 1934, 1935).

At the onset of World War II, the tendency was towards federalization of taxation at death. This occurred in Canada (with the exception of Quebec and Ontario). In the U.S.A., the defective and anachronistic credit system, outlined below, results in a sort of separation of tax sources by brackets whereby the upper ends of the scale are virtually left for federal ploughing.<sup>(1)</sup>

In the field of borrowing, a gravitational movement is similarly traceable. The experience of Australia should prove enlightening. In fact, as early as 1937, a "Loan Council" was established to replace the independent borrowing powers of federal and state governments in order to avoid competition in the loan market and to secure more favourable terms. There was one representative each of the Commonwealth and of the six states. As the Commonwealth had two votes and a casting vote, it could obtain a majority simply by getting the support of two states.

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(1) See Part One, Chapter I, Section IV.

The centripetal tendencies, which characterise neo-federalism, can be further exemplified by reference to the developments in Switzerland, India and Latin America.

In Switzerland,<sup>(1)</sup> the federal government during the First World War had obtained (temporarily) the right to levy direct taxes on income, capital and excess profits, part of the yields being paid to the cantons. The same occurred in the Second World War with the addition of purchase taxes, the cantons sharing in, the receipts in the proportion of 1/10 to 1/3.

In 1920, the taxpayer paid 37.5 per cent of his contributions to the federal government, 29.3 per cent to his canton and 33.2 per cent to his commune. In 1949, the percentages were 48.9, 27.2 and 23.9 per cent respectively.

The subventions paid by the central government are playing a significantly increasing part. They amounted to 25 million Swiss francs in 1913, 95 m. in 1920, 196 m. in 1938 and 604 m. in 1948.<sup>(2)</sup> The fields covered are social services, health, education and investment.

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(1) Rappard, W.E. op. cit. p.139.

(2) Subventions et Parts Légales. 193e, 213e et 220e fascicules des Statistiques de la Suisse. Bureau Fédéral de Statistique. Berne, 1948, 1950.



As for expenditures, they increased, between the years 1900-1948, in the proportion of 1 to 26 in the case of the federal government and 1 to 14.9 in the case of the cantons.

In India, the following table should also prove enlightening: the planned economy initiated by President Peron

### INDIA.

Union and State Revenue.

Selected Years (Rs.crs.)

Year	Union	State and Local	State as % of Total	Income and Profit Taxes as % of Total
1938-39	73.8	83.2	53	11
1943-44	193.2	140.8	42	54
1945-46	311.4	205.6	39	49
1948-49	392.2	211.6	35	30
1949-50(a)	370.0	234.7	38	24

(a) Revised estimate.

Turning to Latin America, we find that in Brazil the share of the federal government in the total tax receipts, in 1940 was 57 per cent, and the municipalities' share was 9.1

- (1) United Nations : Public Finance Surveys: India. New York, November, 1951. p.39.  
The state revenues do not include the share in the federal income tax. It is noticeable that, up to 1945-46 some states, now in Pakistan, were included.



per cent. By 1946, the percentages were 61.2 and 4.8 respectively.

In Colombia, the federal government procured 50 per cent of total tax yields in 1940 and 60 per cent in 1948.

Clearly, the planned economy initiated by President Perón in Argentina exerts a strong centralist impact. The one party system in Mexico does not militate in favour of regional responsibility. Similarly, Haiti and Cuba are on the way towards more integration. In the former, besides the control of local revenue, a "Reserve for Communal Public Works" was created and nurtured with the municipal budget surpluses.<sup>(1)</sup>

The first major responsibility pertains to the achievement of fiscal equity in its various aspects.<sup>(1)</sup>

Extra-local unjust taxation must be coped with. It is due to inadequate local resources and/or to rigid powers of regressive character. The national government can increase the local fiscal potential directly and indirectly in two ways, namely by addition and by subtraction. Addition, which leads to both expansion and concentration of local taxable capacity, includes urban

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(1) Johnson, John : "The Latin American Municipality Deteriorates." 1951. p.24.

See Part One, Chapter I, "Fiscal Inequities and Inequalities."

## V. THE NATIONAL GOVERNMENTS' RESPONSIBILITIES.

Local government, at the present stage of economic development and socio-economic philosophy, cannot retain its full classical sense of local autonomy implying separate economic powers and policy-framing. This view applies to unitary countries and even more strongly to federal countries.

In the writer's view, the national government, in both unitary and federal polities, should assume four major responsibilities.

The first major responsibility pertains to the achievement of fiscal equity in its various aspects.<sup>(1)</sup>

Intra-local unjust taxation must be coped with. It is often due to inadequate local resources and/or to rigid monotaxing powers of regressive character. The national government can increase the local fiscal potential directly or indirectly in two ways, namely by addition and by redistribution. Addition, which leads to both expansion and diversification of local taxable capacity, includes urban development, housing schemes, land reclamation, all resulting

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(1) See Part One, Chapter I, "Fiscal Inequities and Inequalities."

in increased local assets and enhanced site values. Equally important is the economic expansion of financially deficient areas through investment promotion and attainment of high employment levels.

The granting of subsidies also exerts a beneficial impact since, in their absence, the local authorities may be driven to resort to additional, and generally, regressive taxation or alternatively to provide sub-standard services or abandon altogether certain services or relinquish services they can, or should perform, to the national government.

On the distribution side, it is most desirable to correct the cumulative concentration of industries, income or population in particular areas. There ought to be some dispersion of resources and some hammering out of inter-area discrepancies in income per head whether in the old federations or the newly formed federations exhibiting strong inter-territorial disparities in wealth or area such as the Central African Federation or Nigeria. The consolidation of small areas is sometimes advisable.

Wide inter-local tax differentials, not due to differences in per capita service quantum or service standards, should not be tolerated on account of the ensuing unfair treatment of similarly financially situated taxpayers, individuals or firms, residing or operating in diverse localities. The present cosmopolitan nature of income, notably corporate

income, owing to its diversification and ramification all-over the nation's subdivisions, ushers in the intricate problems of residence, origin and situs. Horizontal overlapping is often difficult to avert even if all taxing localities adopt uniform provisions and homogeneous allocation devices or allocation formulas. The result of multiplex tax loads is detrimental to economic development.

The national government disposes of three main solutions for coping with inter-area fiscal inequalities. It can encourage the local units to adopt uniform or less dissimilar tax provisions and rates and can induce them to apply similar principles for the purpose of inter-local personal income allocation (residence or situs) and identical devices for inter-local business income allocation.

The alternative solution is for the national authorities to enforce the uniform tax patterns and to impose the homogeneous personal income taxation principles and corporate income allocation methods or formulas.

The second line of approach is for the central government to enhance inter-local agreements whereby a junior taxing jurisdiction grants the taxpayer a credit, on a reciprocal basis, for taxes paid to another junior authority on the same item, the duplication being due to the co-application of the principles of origin and residence. The variants of inter-local tax crediting and the inherent complexities, are reviewed.



The need for generalising a uniform method is underlined.

The third line of approach lies in the introduction of such schemes as the local supplementation of central taxes and/or central-local tax-sharing. The centralisation of tax administration and collection are, in any case, most desirable.<sup>(1)</sup>

Some of the reforms outlined, whether they are implemented through inducement or compulsion, are likely to meet with considerable opposition on the part of the minor governments, particularly in federalism where the intermediate authorities are on strong constitutional ground.

Furthermore, some of the solutions militate in favour of certain localities and other solutions militate against other localities. The basis of residence, for instance, causes prejudice to the debtor areas which would rather prefer the principle of situs or origin. In connection with inter-local credits, the resident-credits (i.e. credits to residents) suit the debtor areas while the non-resident credits handicap them.

Various consequences, some undesirable, are liable to follow certain solutions of local finance problems. An example is provided by the fact that the universalization of the principle of residence may induce the high-income recipients to migrate to the lowly taxed areas. Other non-

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(1) Part One, Chapters I and II. Part Three, Chapter V.



human resources may follow. This impoverishes the highly taxed areas, often the under-endowed ones, thus adding to their hardships.

A further aspect of fiscal inequity, namely the central plus local repressive tax burden, must not be omitted by the supreme taxing authority. If taxpayers, individuals and firms, have to pay heavy taxes to more than one government layer, there is a possibility that more than a hundred per cent tax is ultimately collected. This entails fiscal inequity on the part of the same taxpayer and also involves fiscal inequalities especially between concerns operating in different areas some of which are income-taxing and some others are non-income-taxing areas.

The national government has the responsibility of finding a remedy for central-local fiscal inequity and its adverse economic impact. It can have recourse to such devices as central-local tax crediting and tax deductibility, which are particularly helpful in federal countries, or to outright centralization with tax-sharing.<sup>(1)</sup> Tax-crediting reduces the tax due to the central government by the amount paid to the lower jurisdictions. Deductibility, whether reciprocal or unilateral, reduces the tax base by the amount of tax laid by

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(1) See Part Three, "Intergovernmental Fiscal Co-ordination", Chapter V.

the other authority.<sup>(1)</sup>

In finding remedies for the problems of fiscal inequities, the national government should not overlook the further repercussions of the different devices, and their variants, on the progression of the central taxes, the local taxes and ultimately the scale of the national tax system as a whole, that is, central plus local taxation.<sup>(1)</sup>

Furthermore, the impact of the devices adopted on the revenue collected by both the senior and junior authorities ought to be reckoned with.

Part of the national government's first major responsibility of fostering fiscal equity, regards the two other aspects of the fiscal process, namely expenditures and the spatial scope of equity.

As will be expounded later, parallel consideration of both taxation and expenditure of the proceeds is necessary to determine the true or effective fiscal burden. Consequently, the national government must see that the underlying authorities, taken separately, adopt fair taxes combined with redistributive spending policies and that the various local units, taken together, do not exhibit sharp inequalities inter se in the fiscal residua (i.e. the net result of both taxation and expenditure) of taxpayers not dissimilar in any relevant

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(1) See Part One, Chapt I, Section II "Local Personal Income Taxation."

respect, residing in different local areas. The central government will have to put into effect some system of transfers of funds from the high-capacity areas to the low-capacity areas.

The ideal guiding the national authorities' policy-decisions may be that of achieving maximum general welfare for the community as a whole, in other terms, increasing the sum total of net benefits, that is, the aggregate benefits of expenditures less the aggregate sacrifices of taxation, of all government layers.

In this case, the central authorities will have to see that the objective is approximated not only within its field of action, but also within all local areas without exception. The latter point is of especial significance in federal countries. All similar financially situated citizens, residing in different subordinate units of varying taxable ability, must enjoy the same degree of social utility or general welfare as engendered by both central and local authorities; while incurring similar degrees of sacrifice as imposed by both major and minor authorities.

Assuming that each junior authority taxes according to the principle of equi-marginal sacrifice and spends according to the principle of equi-marginal social benefit and assuming that each locality reaches the optimum point in its revenue/expenditure policy by equalizing marginal sacrifice with

marginal benefit, it will be found that the inter-local equality in marginal sacrifices and marginal benefits is not possible. This is due to the existence of disparities in local per capita wealth and income. In wealthy areas the marginal sacrifice will be lower and the marginal benefit also lower, compared with poorer areas. The consequence is that residents of wealthy areas will be more favoured than residents of under-privileged areas.<sup>(1)</sup>

The national government, having wide fiscal powers and being unimpeded by geographical boundaries, will thus have to step in with a programme of financial aid (intergovernmental transfers) and/or inter-area tax adjustments.<sup>(2)</sup>

In sum, the central authorities, in unitary and federal countries, ought to aim at equalizing the benefit derived from the marginal unit of expenditure, central and local, all-over the nation's subdivisions, with the sacrifice incurred in raising that unit of revenue by both major and minor authorities, rich and poor.

(1) Part Three, "Intergovernmental Fiscal Co-ordination."

(2) This is clearly easier to achieve in unitary countries than in federal countries. In the former, there are also degrees of easiness depending on the strength of local government.

(1) Part Three, "Intergovernmental Fiscal Co-ordination", especially Chapt IV.



The second major responsibility of national governments, besides the compensatory function, consists in achieving the inter-area equalization of the net fiscal pressure at a high level of general welfare and not at any level. This does not only involve bringing the backward areas up to the standard of wealthier areas but also means a higher standard for all the territorial subdivisions of the same country. A national programme can be drawn for this purpose by providing for supplementary subsidies to the various underlying authorities.<sup>(1)</sup>

The central aid programme must be rationally comprehensive and conditional upon achieving the national service standards. The amount of the subventions will be evaluated on the basis of local fiscal capacity the best criterion of which is local per capita income.

It is noteworthy that the piecemeal subventions refer to individual or occasional services and thus fall short of achieving an all-nation socio-economic adjustment. These haphazard grants may even accentuate, rather than smooth, the inter-area disequilibria. The matching grants assume a certain local fiscal potential and consequently militate in favour of rich areas and against under-privileged areas. This is especially the case in times of slump. Moreover, the constant-ratio grants do not account for the regional

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(1) Part Three, "Intergovernmental Fiscal Co-ordination", especially Chapt IV.



differences in costs of services. As for the special-formula grants, they are often based on unsatisfactory means particularly if these means become stilted through lack of modification to conform to new conditions.

The third major responsibility, which has to be assumed by the national governments, is to cope with the problem of the inadequacy of local revenue. The underlying authorities should be given as wide a fiscal basis as is compatible with two desiderata, on the one hand the development of local responsibility and "political education in democracy" and, on the other hand, the requirements of "fundamental central controls." (1)

Various courses of action can be taken. There are notably the correction of local economic vulnerability, the mitigation of various unnecessary limitations to local taxation, the search for new sources of local revenue and meeting the problem of multiplex small units. (2)

Local economic capacity, the basis of local fiscal potential, can be enhanced through a better inter-area redistribution of economic resources, including manpower and

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(1) Hicks, U.K. : "The Proposed Fiscal System for the Central African Federation."  
Oxford, November, 1952. p.1-2.

(2) Part Two, Chapter III, "Revenue Inadequacy."

(1) Part Two, Chapter III, Section I, "Local Economic Vulnerability."

their diversification within the locality. The latter fact is of especial importance in pluritaxing localities and proves particularly helpful during economic fluctuations.

It is noticeable that the factors of production and hence the financial resources, move more readily from locality to locality than from country to country.<sup>(1)</sup> This is sometimes generated by inter-local competition whereby, some authorities, especially in federal countries, strive to entice away taxable resources from their neighbours with the bait of lower tax rates, under-assessment, exemptions, cash payments, non-interest loans, offer of premises and other concessions. The national government must clearly prevent such practices from being carried too far owing to their detrimental impact not only on the under-privileged localities but also on the utilization of resources along the lines drawn by the "central" policy-makers.

As for the limitations to local taxation, it is sometimes desirable to introduce more flexibility to already existing taxes. The receipts from the local property tax, for instance, may be adversely affected by rigid ceilings, too many exemptions (e.g. U.S.A., Egypt), or under-assessment (e.g. U.S.A., England). The costs of collection and compliance of other taxes may be high and could therefore be reduced

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(1) Part Two, Chapter.III, Section I, "Local Economic Vulnerability."

(2) Part Two, Chapter.III, Section I.

through the centralization of administration, tax sharing or local supplementation of central taxes. This is often the case with local income and business taxes and local consumption taxes, specific or general, owing to overlapping and/or evasion.<sup>(1)</sup>

There is scope for adding to local revenue without the undesirable inequities. The central government could play a useful role by deciding or suggesting new sources or relinquishing to the underlying authorities certain levies of local character. Illustrations are afforded by the taxes on site values, entertainments, motor-vehicle, petrol, hotel rooms, restaurants, drinks and some selective commodity taxes. There is also ground for providing the lower authorities with extra powers in emergencies.

As regards the size of the local areas, it is noteworthy that the small unit has a fragile financial position and a high per capita cost of service.<sup>(2)</sup> There is a definite need for wider areas more in line with modern conditions. The responsibility falls on the national government which, being the supreme authority, can consolidate or redraw the boundaries, enhance inter-local co-operation through regional boards and generally further inter-governmental fiscal co-ordination.

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(1) On the limitations of various sorts on local taxing powers, see:- Part Two, Chapter III, Section II "Limitations to Local Taxation."

(2) Part Two, Chapter III, Section I.

Municipalities should be enabled to absorb easily the peripheral areas instead of being discouraged and sometimes even precluded by legislation from doing so as in many states in the U.S.A. <sup>(1)</sup> The process of suburban development, which wreaks havoc with local revenue, calls for drastic reforms. However, insurmountable difficulties may be encountered in the case of federal countries where the fringe areas lie in other states.

The fourth major responsibility with which must be saddled the national governments in unitary and federal countries alike, is the achievement of intergovernmental fiscal harmony in both policies and timing. The central authorities must possess sufficient effective control and central finances must enjoy enough flexibility not only to pursue a policy of economic stabilization and to counteract fluctuations in given localities (owing to their over-sensitivity) but also to achieve full employment and high investment levels. The latter objectives require the co-ordination of central and local policy-framing. Indeed, national full employment programmes, full-scale investment promotion and comprehensive social services schemes necessitate the co-operation of both junior

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(1) This is especially the case in New England, Middle Atlantic and the Midwestern states where the state laws require the approval of the electorate or property owners of the area to be annexed by the municipality. See Sigaboos, Robert "The Urban-Rural Fringe Population Problem and Effects on Municipal Finance" in Current Economic Comment. November, 1952.



and senior authorities and an all-tier harmonizing taxing, borrowing and spending powers. The underlying authorities must respond to the nation-wide economic and social policies underwritten by the central government.

Various methods have been suggested for the co-ordination of intergovernmental fiscal relations. In the absence of such attempts, sundry central-local or inter-local contradictions make their appearance not only in the field of fiscal equity but also in connection with economic policies.<sup>(1)</sup>

In fact, the interjurisdictional fiscal frictions, in the economic sphere, affect two main aspects, namely; conflicting effects and lack of synchronism.<sup>(2)</sup>

The distortionary or disruptive impact of the divergent application of local fiscal powers finds expression in the fields of investment, consumption (quantity and quality), the price system, industrial location, the inter-area distribution of labour, the distribution of income by brackets and type and even inter-local and foreign trade. These interjurisdictional horizontal and vertical conflicts are ushered in by local property taxation, local income taxation, local outlay taxes

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(1) It is sometimes difficult to conciliate local financial responsibility and the need for central control, e.g. the central-local sharing of income taxation according to rigid proportions fixed by the constitution.

(2) See Part Two, Chapter IV, "Intergovernmental Fiscal Policy Conflicts."





especially the local specific and general commodity taxes.

Similarly, the local spending powers not only can have misallocative effects on resources but can also adversely affect the dual tenet of fiscal equity viz. fair taxation and redistributive spending.

As for the lack of intergovernmental synchronism in taxing, borrowing and spending powers, it carries vital implications within the framework of national-local fiscal relations.

In boom, local taxation may be alleviated (especially if local bodies are dominated by special-interest groups), or the local councils may launch extensive capital works thus aggravating, through ill-timing, the inflationary spiralling of prices.

The underlying authorities can thus intensify the violence of economic convulsions by following the swings of the cycles rather than counterpoising them in conjunction with overlying authorities.

Consequently, it clearly emerges that the national governments, in unitary and federal countries, have the duty to mitigate both intergovernmental fiscal antagonism and intergovernmental fiscal anachronism.

In conclusion, modern local government must be of a co-operative character. Major and minor authorities should become "co-operative partners" rather than "antagonistic

partners." This applies to unitary as well as federal countries. The neo-federalism advocated must be substituted for paleo-federalism involving parallel or competing financial functions.

There is no inherent conflict between the concept of local government propounded here and the desirability for some local government responsibility. Responsibility is simply not to be construed in an egotistic sense and cannot be confined to the local community but must have a double import; the welfare of the local community within the framework of national welfare.

Minor governments can be no more fully sovereign within their assigned sphere of activity. The traditional conception of local autonomy is an historical anachronism in present-day conditions. It suited times when political freedom was still questioned and economic individualism reigned supreme.

The present study tackles, in Part Three, the means to co-ordinate central-local and inter-local fiscal relations in unitary and federal countries.

No panacea can be pointed out as the cure for all maladies in all countries. Political, social and economic conditions vary. The solutions propounded, therefore, differ from country to country, and within the same country may have to be modified from time to time.

Therefore, a general discussion of the principles underlying the suggested reforms is most desirable.

PART ONE. ONE.

FISCAL INEQUITIES. INEQUALITIES.

## PREFACE.

### 1. THE CONCEPT OF FISCAL EQUITY WITHIN THE FRAMEWORK OF CENTRAL-LOCAL FISCAL RELATIONS.

## CHAPTER ONE.

Fiscal equity is an easily definable concept. It is greatly relative to the particular socio-political, economic and cultural conditions prevailing. Equity is therefore both historical and relative. However, it is desirable, for the purpose of simplification, to present a simple simplification of the concept. The central tenet of equity may be taken as the equal treatment for persons dissimilar in no relevant respect or "equal treatment for equals."

As Professor Pigeon puts it, "Different persons should be treated similarly unless they are dissimilar in some relevant respect."<sup>(1)</sup>

This definition of fiscal equity is generally construed with reference to the burden of taxation alone. It is however possible to extend it to the expenditure side. In fact, taxation is a dual operation which implies subtraction or

[1] Pigeon, A.C. : "A Study in Public Finance." London, 1933. p.9.

Prof. Sidgwick also states that: "Similar and similarly situated persons ought to be treated similarly."

## PRELUDE.

### I. THE CONCEPT OF FISCAL EQUITY WITHIN THE FRAMEWORK OF CENTRAL-LOCAL FISCAL RELATIONS.

Fiscal equity is not an easily definable concept. It is greatly relative to the particular socio-political, economic and cultural conditions prevailing. Equity is therefore both historical and relative. However, it is desirable, for the purpose of our present study, to proceed to some simplification of the concept. The central tenet of equity may be taken as the equal treatment for persons dissimilar in no relevant respect or "equal treatment for equals."

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(1) Pigou, A.C. : "A Study in Public Finance." London, 1928.  
p.9.

Prof. Sidgwick also states that: "Similar and similarly situated persons ought to be treated similarly."



sacrifice as well as addition or social benefit. There are constant actions and reactions on the people from both taxation and expenditures. It is, therefore, necessary, to consider the relative post-taxation as well as post-expenditure positions of the citizens.<sup>(1)</sup>

This comprehensive conception of fiscal equity is more appropriate, even essential, in the modern economic conditions of the Welfare State where redistributive finance supersedes neutral finance. Full fiscal equity carries important implications both per se and within the framework of central-local fiscal relations.

- (1) The concept of "social or general welfare" is not the old individual-benefit principle or quid pro quo, based on cost of service or protection theories. Benefit, in an ethical-collective connotation, is what we mean here when we refer to the spending side of the fiscal process. See;

Wagner, Adolph : Finanzwissenschaft. Leipzig, 1890, II pp.431-442.

Wicksell, Knut : Finanztheorie Untersuchungen. Juna, 1896. p.82.

Adarkar, B.P. : The Principles and Problems of Federal Finance. London, 1933. pp.187-211.

Barna, Tibor : Redistribution of Income Through Public Finance in 1937. London, 1945. p.3.

Hicks, U.K. : Public Finance. Cambridge, 1947. p.281.

See also H.M. Groves, W.J. Shultz, C. Heer and others.

As the apportionment of the fiscal burden is affected by both taxation and expenditure, the progressive structure of the tax system is fostered, or rendered less regressive, through sound redistributive spending.<sup>(1)</sup>

On the other hand, the tax proceeds may be spent in such a way as to advantage the high-income receivers as often occurs in a-democratic countries. The aggravative effect of expenditures then counteracts or negatives the progressive structure of the tax system or renders it more regressive if it is already so.

When, however, expenditures follow, in their benefit-distributive effects, the same lines as the tax rate structure, no divergent action is generated.

In sum, the tax variables and the expenditure variables must be both taken into consideration before a proper estimation is made of the effective scale of graduation of the taxes. What has really to count is the final fiscal pressure of both taxation and outlay. The fiscal residuum ought to be the right criterion of progression or regression.

From the viewpoint of intergovernmental relations, the over-all fiscal system, central and local, together should

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(1) Buchanan, J.M. : "The Pure Theory of Government Finance, A Suggested Approach."

The Journal of Political Economy. Dec. 1949. p.496.

should desire to reside in the nation. The over-all fiscal treatment which he receives will be approximately the same.

See Buchanan, J.M. : "Federalism and Fiscal Equity."

The American Economic Review, Sept. 1950, p. 589.

Compare Johnson, Byron in a similar definition quoted below (Part Three, Chap. V, Sect. 1).

provide for equal treatment to equals residing in any local unit within the national boundaries. Local residence per se must not justify varying fiscal treatment (i.e. taxation plus social benefit).<sup>(1)</sup>

Consequently, fiscal equity should not solely purport separately to central or local taxation, or even to both but must refer to central and local taxation/expenditure concomitantly.

To sum up, the net fiscal burden or fiscal residuum (whether positive or negative) must, by pertaining to taxation cum expenditure, involve all tiers of taxing authorities and spending authorities.

In other words, the whole hierarchical structure of taxing jurisdictions, particularly in a federal polity, has its part to play in achieving fiscal equity. The dual fiscal process considered has to take into account both taxation and expenditure of senior or junior authorities combined. The net effect on local residents of all these sets of taxes and expenditures determine the fiscal residua.

We may now enumerate the major factors which affect the apportionment of the final fiscal burden of central plus local

#### Footnote

- (1) "An individual should have the assurance that wherever he should desire to reside in the nation, the over-all fiscal treatment which he receives will be approximately the same." See Buchanan, J.M.: "Federalism and Fiscal Equity."

The American Economic Review, Sept. 1950, p. 589.  
Compare Johnson, Byron in a similar definition quoted below (Part Three, Chap. V, Sect. I).

aspects, on account of one or more of the following factors

1. The Central Tax Scale :

The progressiveness of the central tax system may have been made to affect mainly the higher income brackets rather than the low income brackets. If the central taxes are only mildly scaled while the low income-receivers are subjected to heavy local levies, the ultimate structure of the national tax system, that is central plus local taxation, will be clearly unfair.

The same result obtains if the central tax system, although covering all the income ranges, is not distinctly scaled.

An illustration is afforded by the U.S.A. in 1938 when the federal tax was a little less regressive in the lower groups than the state and local taxes. The federal tax rates were low and progression mild. During and after World War II the situation clearly changed. Under the pressure of expanding expenditures, the federal tax rates went up and became strongly progressive.

To sum up, it is necessary not only to have a distinctly progressive central tax system, but also the majority of the population must be brought within the graduated scale of central taxation.<sup>(1)</sup>

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(1) Colm and Tarasov : Who Pays The Taxes?  
 Temporary National Economic Committee. Monograph No.3,  
 1940.  
 Facing The Tax Problem, Twentieth Century Fund.  
 New York, 1937. p.237.



## 2. The Local Tax Scale :

The local taxes may be proportional or regressive in their formal or effective incidence, owing to the imposition of levies regressive by nature, e.g. the property taxes and the local outlay taxes, or because of the regressive structure of local taxes not necessarily regressive by nature, e.g. the local income taxes.

If local taxation is important and its regressiveness serious, the progression of the national tax system as a whole will be vitiated.

## 3. The Local Taxing Policy :

The local units ought to proceed in taxation according to the principle of equi-marginal sacrifice. In this case, the under-privileged areas, having a low per capita income, will have a higher marginal sacrifice than that prevailing in wealthier areas which, owing to their high per capita income, will have a comparatively lower marginal sacrifice.

The outcome of inter-area inequalities in marginal sacrifices is inter-area disparities in the tax burden falling on similarly situated persons residing in different local areas.

## 4. Central Spending Regressiveness :

The central authorities may apply the proceeds of their



taxes to regressive spending or to spending which benefits the high-income groups. The latter fact is conducive to less progressive or, eventually to regressive taxation. This often occurs within an undemocratic or an anti-democratic national government especially as<sup>n</sup> aristocratic one.

It is noteworthy that "aggravative" expenditures may also affect the form of "detaxation", or tax relief benefitting the upper-income recipients, made possible by the tax proceeds secured from the low income-earners.

#### 5. Local Spending Regressiveness :

The junior authorities may formulate non-redistributive tax/expenditure policies by providing social benefit according to the quid pro quo principle<sup>(1)</sup> or dispensing it equally among all local tax-payers, high as well as low income-groups. The minor governments, especially when undemocratic, may also make use of the tax proceeds to the advantage of the high-income groups by conferring relatively more benefits to them.

In all these cases, local taxation maintains the (regressive) status quo and tends to be regressive if it is

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(1) The individual-benefit principle accepts as "natural", the existing property and income distribution. As the latter may not be sound, the local tax system as a whole (i.e. taxation in conjunction with spending) will not be equalitarian.

proportional or progressive. It also tends to be more regressive if it is already so.

#### 6. Local Spending Policy :

The local units ought to proceed, in the field of expenditure, according to the principle of equi-marginal social benefits.

If this is the objective, the poorer areas, suffering from inadequate resources and having greater needs, will have higher marginal benefits than wealthy areas which, enjoying high per capita wealth and income, will have lower marginal benefits.

Consequently, as in the well-off areas equi-marginal sacrifice is lower and equi-marginal social benefit is also lower, the optimum in the finances of the prosperous locality will be reached at a lower level than in the case of the low capacity localities.

Therefore, fiscal treatment, that is, taxation in conjunction with social welfare, will exhibit inter-area inequalities.

#### 7. Central Subsidization :

The national government, feeling its responsibility for territorial equalization of social utility, may undertake a system of transfer of funds between high capacity and low

capacity areas.

If the central aid programmes does not follow rational lines of inter-local overall adjustment but assumes, instead, the form of piecemeal or haphazard payments, disequilibria are most likely to ensue. Indeed, the matching grants and sundry specific and special formula subventions often favour the already prosperous areas and accentuate disparities in wealth.

Furthermore, the grants may discourage the local authorities from making the best use of their resources. Local reduction of taxation, benefiting the high-income classes, and/or extravagant spending may result from incoherent and unconditional subventions.

In fact, the guiding principle of subsidization should not be merely local budgetary equilibrium but over-all socio-economic equilibrium.

The latter basis is, however, absent at present time from central aid programmes in both unitary and federal countries.

In conclusion, it is noteworthy that, although parallel consideration of tax apportionment and expenditure allocation, should not be omitted in any proper evaluation of the fiscal burden, it is possible, for the purposes of analysis, to envisage the process of taxation and expenditure separately.

Consequently, the concept of fiscal equity, discussed in

the present chapter and in the next chapter, refers only to the taxation side.

The impact of the expenditure side on tax justice is considered in course of the fourth chapter on Intergovernmental Fiscal Policy Conflicts and in course of Part Three dealing with Intergovernmental Fiscal Co-ordination.

major aspects within the framework of national-local fiscal relations, namely: intra-local, inter-local and central-local fiscal inequities.

These forms of unfair tax treatment affect local residents and local business. In the former case, we may distinguish forms of personal, inter-personal and inter-social, or inter-class, fiscal inequities and inequalities. In the latter, we may distinguish business and inter-business fiscal inequities and inequalities.

Clearly, all aspects of inequities may, eventually, overlap.

1. Intra-Local Fiscal Inequity.

This concept, used throughout the thesis, pertains to the various aspects of tax injustice generated within the confines of the one and the same local unit. This may be attributed to four major factors: the imposition of taxes regressive by nature, the structure of the local tax, the heavy or repressive burden of taxation and overlapping.

① The concept of absolute and relative fiscal inequities are therefore also dealt with although we recognize that there are also absolute and relative inequities in expenditure.

II. THE ASPECTS OF FISCAL INEQUITY  
WITHIN THE FRAMEWORK OF CENTRAL-  
LOCAL FISCAL RELATIONS.

Fiscal inequities and inequalities assume three major aspects within the framework of national-local fiscal relations, namely; intra-local, inter-local and central-local fiscal inequities. <sup>(1)</sup>

These forms of unfair tax treatment affect local residents and local business. In the former case, we may distinguish forms of personal, inter-personal and inter-social, or inter-class, fiscal inequities and inequalities. In the latter, we may distinguish business and inter-business fiscal inequities and inequalities.

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<sup>(1)</sup> The concepts of absolute and relative <sup>taxable</sup> ~~personal~~ capacities are therefore ~~also~~ dealt with, altho we recognise that there are also absolute & relative expenditure capacities. See Bhergava, R.N. - The Concept of Taxable Capacity. The Indian Economic Review (The Delhi School of Economics) Feb. 1954 pp 115-120



It is noteworthy that the scope for intra-local fiscal inequity is more serious in pluritaxing junior authorities than within the monotaxing authorities. Consequently, intra-local fiscal inequity assumes more substantial proportions in a federal polity than in a unitary one.

Furthermore, the smaller the taxing unit, of pluritaxing capacity, the heavier local inequity is likely to become.

It ought also to be mentioned that the local revenue deficiencies, aggravated by the rise in expenditures and the fall in the value of money, are conducive to a deepening of regression in monotaxing authorities and/or a widening of its scope in pluritaxing authorities.

The various forms of intra-local inequity may be now reviewed.

The local taxation of real property is clearly regressive since it is not directly connected with ability to pay.

Fiscal inequity, in the case of local income taxation, is likely to stem from the problem of interjurisdictional incomes and income partition. In other terms, the responsible factors are the co-application of residence and situs and income dismemberment by region and by type <sup>of income</sup> for the purpose of local fiscal treatment. In fact, schedular income taxation is irrational, especially when there is no central income tax. <sup>or when the latter is light.</sup>

Proper progression can only apply to the person's total earnings of whatever type and from whichever region.

Progression, when adopted locally, is infringed or defeated through the partition of ability to pay, that is, when the local scale of graduation applies only to slices or fragments of income as determined by region or by type. The fragmentation by region would be caused by the local taxation on the basis of situs and not residence. The fragmentation by type is represented by the local taxation of only some flow, or flows, of income to the exclusion of the others.

Furthermore, the splitting up of personal income and its subjection to schedular local income taxation, whether by the same local unit or by diverse local units, may lead to the multiplication of exemption limits and allowances for the benefit of the same income-receiver.

It is noteworthy that if the local income taxes are substantial and assume a proportional or ~~regressive~~ form and if there is a central income tax system only mildly progressive, the progressiveness of the latter, and hence of the national tax system as a whole (i.e. central plus local), will be impaired and may even become regressive.

Fiscal inequity, in its intra-local connotation, may also affect local business and local industry by falling unfairly on a given concern or through discrimination between similar concerns operating within the same locality. The junior taxing jurisdiction may invoke the theories of Social Expediency, Social Control or General Welfare to justify a host

of regressive and repressive imposts, on local activities, little connected or unconnected with impersonal ability to pay or net corporate income, but based on such items as gross earnings, capital stock or net value output. The regression also manifests itself if the effective incidence of these taxes falls on the consumers.

The intra-local unfair fiscal treatment may be also generated by sundry outlay taxes, imposed by the junior authorities, notably selective and general commodity taxes.

## 2. Inter-Local Fiscal Inequity.

This term expresses the various aspects of horizontal fiscal inequalities or inter-territorial tax differentials not due to differences in local service standards.

Economic as well as fiscal factors are responsible for such disparities.

From the economic viewpoint, the main reason is the differences in local wealth as measured by local per capita wealth or income.

The discrepancies in wealth may be caused either by the natural inter-area distribution of resources or by such structural and organisational factors as industrialisation, specialisation and integration.

Furthermore, economic changes or fluctuations hit the various areas in varying degrees. A normally prosperous

district may be so adversely affected as to suffer pronounced fiscal inequities compared with normally less well-off areas. The general rigidity of the local tax systems has its part to play in this connection.

The inter-area disparities in the tax burden may be also due to purely fiscal considerations.

In the field of personal income taxation, the relative inequalities may be induced by the problems of residence and situs. When no agreement prevails between the various junior taxing jurisdictions as to the criterion, either residence or situs, duplicate taxation arises (unless inter-local tax credits are provided for). Consequently, some uniform basis ought to be adopted.

Furthermore, there may exist inter-local differences in rates, exemption limits, amounts of allowances and other provisions.

Similar considerations lie at the basis of the inter-local inequities in the field of local death taxation.

As for business taxation, the horizontal fiscal inequalities are ascribable to various factors.

In non-income taxation of business, there may be not only disparate local "bundles" of imposts, little connected or unconnected with impersonal ability to pay (as measured by net corporate income) but there may be also inter-local differences in tax provisions with respect to any given levy.



In the case of local corporate-income taxation, there is the problem of pan-locality or cosmopolitan income. If within the same country, some localities base taxation on situs of business regardless of jurisdictional source; while the other localities tax on the basis of the origin of business income (i.e. income originating within their respective spheres irrespective of situs) multiple taxation ensues.

If the local units, in an attempt to apportion cosmopolitan business income, adopt the devices of allocation formulas or separate accounting or the ratio of local to total expenses, identical processes must be applied otherwise duplicate taxation will still persist.

It is to be mentioned that the creditor and debtor localities will not easily agree to the same device as their interests are not reconcilable especially if the local interest groups are strong. Even if all localities agree on a universal formula, different interpretations and varying emphasis may be attached to the same components.

Clearly, the problem of inter-local fiscal inequities and inequalities becomes more intricate when prevail multiplex local tax systems involving income taxes and/or outlay taxes as is the case in a federal polity.

Furthermore, it is to be mentioned that the heavier the general burden of local taxation, the greater will be the absolute disparities in inter-area tax liability.

### 3. Central-Local Fiscal Inequity.

Vertical fiscal inequity is due to various factors notably the mode of local taxation and the combined burden of central plus local taxation.

Concerning the mode of taxation, it is to be mentioned that the scope for central-local inequities will be wider if the local taxes derive from the same sources as the central taxes than if they are completely separate from the central taxes, unless local taxation affects the form of supplements or percentages on national taxes. The scope for inequities will be also narrower if there is some sort of separation "by brackets" according to which the low-income groups are left for exploitation by the junior authorities while the higher-income groups are kept for the senior or central authorities.

Similarly, tax sharing militates in favour of more vertical equity.

Clearly, the centralisation or federalisation of administration and collection of secondary and tertiary taxation, e.g. property taxation (valuation), income taxation, mitigate the various inequities and inequalities.

Central-local repressive taxation is likely to be the outcome of manifold tax layers. It assumes more serious proportions in federal countries than in unitary countries and is accentuated by the new tides of welfare economics, planned economics, hot-war or cold-war economics which bring about

serious increases in tax rates and substantial widening of the fiscal field.

Vertical fiscal inequity, notable in income taxation, is mitigated by agreements between localities or between the local and central authorities providing for tax credits or tax deductibility, mutual or unilateral. However, there are cases when the devices do not prove satisfactory.

It is important to point out that the plurality of tax layers is liable to exert a detrimental impact on the progression of the national tax system, as a whole, especially when central progression is mild whether the secondary and tertiary taxes are proportional or progressive and, a fortiori, when they are regressive.

Professor Cannon states about medieval England:

"It seems to be quite clear that in the fourteenth and fifteenth century the accepted view was that each inhabitant should pay according to his ability or substance, for in those days ability and substance meant much the same thing: the man who has a large income without having a large capital is a product of modern civilization."<sup>(1)</sup>

(1) Cannon, Edwin: "The History of Local Rates in England," 1927, 2nd edition, p.22.

## SECTION I.

### LOCAL PROPERTY TAXATION.

#### I. PROPERTY TAXATION AND ABILITY TO PAY.

A study of the development of fiscal theories reveals that real property was, in origin, taxed on the ground of ability to pay and not benefit. The early Greek and Roman philosophers pointed to the connection between just taxation and ability as measured by real property. Real property was then the only or the most important form of wealth. On the other hand, the early governments were not concerned with benefits or welfare and the best thing that could be expected from them was to leave the people alone.

Professor Cannan states about medieval England:

"It seems to be quite clear that in the fourteenth and fifteenth century the accepted view was that each inhabitant should pay according to his ability or substance, for in those days ability and substance meant much the same thing: the man who has a large income without having a large capital is a product of modern civilisation."<sup>(1)</sup>

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(1) Cannan, Edwin : The History of Local Rates in England.  
1927, 2nd edition. p.22.



Similarly, in the U.S.A., the property taxes were originally based on ability. An Ordinance of Massachusetts Bay Colony, in 1634, speaks of taxing everybody "according to his estate and with consideration to all other abilities whatsoever."

Gradually, the scope of government activities widened. An increasing range of services began to be provided for. The expansion of trade and the development of urban centres called forth such services as roads, water, and other municipal utilities and amenities. Police and fire protection had to keep pace with new conditions. Health and education were also added to the list. The result was an increasing burden of expenditure to be met through an increasing burden of taxation. The property owners were naturally the most liable to contribute. Some of the services benefited them and other services did not.

The reluctance of the property owners to pay for others or to have to contribute at all to public funds, while other income-earners did not, induced them to invoke the quid pro quo principle which thus "proved to be only a detour, an effort on the part of property holders to circumvent the movement for expansion of the social responsibilities of government." (1)

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(1) Simpson, Herbert D. : "The Changing Theory of Property Taxation." in The American Economic Review. pp. 125-126. September, 1939. p.453.

Legal history, either in Britain or the U.S.A., reveals how the property owners were keen to claim the benefit principle in a desperate attempt to defend themselves and how the legal decisions faithfully reflected this view. An expressive instance, inter alia, may be quoted. The Supreme Court of Michigan finds that:

"Every species of taxation in every mode is in theory and principle based upon an idea of compensation, benefit or advantage to the person or property taxed. Taxation, not based upon any idea of benefit to the person taxed, would be grossly unjust, tyrannical and oppressive and might well be characterised as public robbery."<sup>(1)</sup>

It is noteworthy that the "contract theory" provides the philosophical background to the quid pro quo principle. The fiscal counterpart of the concept of social contract is "a give-and-take" basis; rights entail duties and services justify counterservices.

Several reasons account for the waning of the benefit theory both as a protection theory (or cost-of-service theory) and a value-of-service theory (or interest principle).<sup>(2)</sup>

With economic expansion, sundry forms of wealth developed

(1) Williams v. Mayor of Detroit, 2 Michigan 560 (1853).

(2) Seligman, Edwin R.A. :  
 Studies in Public Finance. New York, 1925. pp.185-186.  
 Essays in Taxation. 10th ed. 1925. p.337 et seq.

which cannot be overlooked. If in an agrarian community, real property is the main form of wealth, in a trading and industrial community it is a form *inter alia*.

Furthermore, not all services can now be viewed as "land services". An increasing proportion is rather personal in character and does not accrue to the property *per se*. Gas, electricity, sewage disposal do not exclusively benefit real property but are also performed for reasons of public hygiene or public security. Roads, cleansing, parks, clubs and other amenities can hardly be said to relate to property. In the Welfare State, the non-property owners are likely to derive more benefit than the property owners either on the central level or on the local level.<sup>(1)</sup>

Various socio-economic and political considerations induced corresponding changes, of fundamental character, in the philosophy of taxation. The "Interventionist State", the "Planning State" and the "Welfare State" involve varying degrees of rationalization and mobilization of human and economic resources for the sake of definite ideologies.

These more organic theories of the State call for a more appropriate theory of taxation, more equitable and more malleable as an instrument of policy. Ability to pay is the answer.

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(1) Wagner, Adolph : Finanzwissenschaft. Leipzig, 1890, II. pp.431-442.

## II FISCAL EQUITY AND LOCAL PROPERTY TAXATION ON RENTAL VALUE

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### 1. Intra-Local Fiscal Inequity.

#### 1. Regression: Reasons: <sup>(1)</sup>

Owner and Occupier: In a rational fiscal system, real property would be subject to taxation on the income it actually yields, not as a distinct flow but as part of the stream of income flows which accrue to the individual. The segregation of property, or income from property, for the purpose of separate fiscal treatment either on the central level or on the local level, is fraught with distortions of the ability principle and fiscal equity.

When a local tax is imposed on property, on the basis of rental value, it may be payable either by the owner or the occupier.

If the local tax falls on the owner and if there is a graduated central income tax system not including income from property, the result is that the property-income-earner may be ultimately either under-taxed or over-taxed. If his income from property is an element in his total income, his position

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(1) In the present section, property taxation refers to residential property and land. Business property is discussed in the next section.



in the scale of graduation of national income taxation is unjustifiably lowered. The fiscal burden is thus unnecessarily mitigated.

Conversely, if the owner's property income is the only income he earns or forms the largest element in his total earnings, he may still be below or at subsistence level. Taxing him then, on either the central or local levels, involves fiscal inequity. The justification, in this case, that the property derives benefits through local expenditure on services, is not wholly tenable as already expounded.

Furthermore, when income from property is included in the central income tax system and when, on the local level, property or income from property, is also taxed, we have a case of multiple taxation if the tax is payable by the owner.

It is noteworthy that in many under-developed countries, where investment prospects are limited, people tend to invest in real property, land or buildings. From the viewpoint of ideal fiscal equity, these income-earners ought to be taxed (by any authority) on that portion of income, derived from immovable property, which exceeds their personal and family requirements, according to a graduated scale, otherwise there is unfair treatment.

The most flagrant case of fiscal inequity, in connection with the local taxation of property, arises when the tax is imposed on the occupier instead of the owner as in England

where such taxes are called "rates".<sup>(1)</sup> In fact there is no link between the rent paid and the true taxpaying capacity of the occupier. The low-income receivers spend proportionately more of their income on rent than the high-income receivers. The levy is thus akin to an outlay tax and acquires the same regressive character. Moreover, housing is a necessary party expenditure. The house tax is thus a levy on shelter and conflicts with the modern concept of the Welfare State whereby the latter strives to promote the living conditions of the masses. The expenditure on houses, unlike those on drinks or tobacco, should be encouraged and made part of any "progressive social system."<sup>(2)</sup>

Regressiveness exists not only between the social classes, that is, "inter-class fiscal inequity", but also between individuals within the same class, that is "inter-personal fiscal inequity". In fact the amount of rent paid out of a given amount of income varies according to various "personal" considerations. The assessed value of a large house is no criterion of taxpaying capacity of the occupier with a large family. Furthermore, the renter-occupier may be forced to reside near his place of work although he might have preferred

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(1) In Scotland, the liability is divided between landlord and tenant.

(2) Hicks, J.R., Hicks, U.K. and Leser, C.E.V. : The Problem of Valuation for Rating. Occasional Papers VII. National Institute of Economic and Social Research. Cambridge, 1944. p.6.

to move to some other premises more in accordance with his income capacity or ability to pay. Needless to say, the richer occupier can more easily shift to lowly rated rates or to smaller houses or lodgings. Similarly, unemployment and old age, involving absence of personal earning ability, are not taken into consideration in the pattern of local property taxation under discussion. Indeed, ability to pay can only be reckoned in terms of income and not property.

Valuation: It ought to be mentioned that an important cause of severance between income from property and ability to pay is represented by the problem of valuation. Valuation is generally based, not on the actual rental value of the property but on a rent which a hypothetical tenant would be prepared to pay in a free market. This is understandable since the property may be occupied by a relative of the owner or the owner himself. However, valuation is undertaken only periodically. It is a costly and arduous operation which cannot be carried out annually. Mrs. Hicks asserts that; "Valuation is a skilled job, and a thorough revaluation requires the service of expensive personnel for a considerable period. Consequently valuations tend to be scamped or postponed, until with the passage of time they become quite out of line with each other and with the facts." (1)

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(1) Hicks, U.K. : Public Finance. Cambridge, 1947. p.275.  
 also,  
Hicks, J.R. - Hicks, U.K. and Leser : op. cit. p.76.  
 It is worthy of note that some Dublin valuations date back to 1850!

In a dynamic economy, rent is liable to change. Its fluctuations are generated by economic and other factors. The tax burden will, eventually, lose touch with taxpaying capacity. In depression, the rent of lands and buildings may be adversely affected by a deficiency in effective demand of private consumers including their demand for durable goods. If valuation does not correspond to the new situation the outcome will be a case of over-taxation. Conversely, in periods of prosperity or inflation, rents rise whilst valuation does not keep pace with them. This is conducive to under-taxation.

Besides the stickiness of valuation, it is noticeable that the true rateable or assessment value may not be wholly adopted as the basis for taxation. It may be artificially reduced by different proportions for various purposes outlined later.<sup>(1)</sup> This under-assessment is an additional factor making of valuation not only a source of intra-local fiscal inequity but also a cause of inter-local fiscal inequalities tackled below with special reference to England. Under-assessment is, also resorted to in the U.S.A. and is discussed in due course.

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(1) See Part Two, Chapter III "Revenue Inadequacy", and Chapter IV "Intergovernmental Fiscal Policy Conflicts", Section I.



Derating: The regressiveness, inherent in the English local rates, has been further accentuated by the process of derating of agricultural and industrial hereditaments.<sup>(1)</sup> Local expenditures and notably the increase in them (due to the expansion of services or simply inflation) has thus to be borne by residential property and small shops.

The direct consequence of derating was the lowering of rateable values and the yield of a penny rate by some 12 per cent. Any further increase in the rates had to be 12 per cent higher than before derating. In industrial areas the effect was more pronounced. In Durham, for instance, just after derating, a penny rate brought in 29 per cent less than before.<sup>(2)</sup> Similarly, in expanding industrial areas, e.g. outside London and the Midlands, the expansion in services induced by developing activities (lighting, roads, housing, fire brigade...) led to a heavier burden on residential property.

In 1939 roughly 55 per cent of the rates were paid by occupiers of dwellings, but less than 5 per cent came from

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(1) The derating of agricultural land began as early as 1896 (Agricultural Rates Act) until in 1929 it was completely exempted. As for industry, most kinds of machinery were derated in 1925. In 1929 the rateable value of factories, railways and mines was reduced by 75 per cent.

(2) Local Government News Service - October 1931.

houses with a rateable value above £50. More striking is the fact that the occupiers of small residential shops contributed relatively more than the whole of industry and railways (5 per cent and 4 per cent respectively of the local rates).<sup>(1)</sup>

Uniform Valuation and Regression: To undertake in England a revaluation on a uniform basis, such as was proposed in 1938, is conducive to accentuation of the regressive impact of the local rates. In fact, the poorer houses tended to be relatively more undervalued than the better houses. Consequently, the increased burden of the rates would fall on the low-income groups and the modest owner-occupiers who were purchasing their houses on mortgages which do not take account of the changes in rateable values.<sup>(2)</sup>

Furthermore, proper valuation is liable to induce a regressive shift of incidence on account of the relative shortage of supply of the smaller houses whose uncontrolled rents and consequently gross values would increase relatively more than the larger dwellings.

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(1) Local Government News Service, July 1939. The rates in Labour Research Department.

(2) "Rates and Values". in; The Times. May 20, 1953. p.9.

Conversely, the rate poundages may be high while the

## 2. Regression: Evaluation:

The burden of any tax can be best ascertained by referring it to income. This applies to central as well as local taxation. In the case of England, which is chosen to illustrate the regressiveness of local property taxation based on rental value, the same method must be resorted to. In other terms, we ought to compute the proportion of the rates to the income of the ratepayers.

Taking the rate poundages as a criterion of regression is not a satisfactory procedure not only because the connection between rates and income is absent but also on account of the general stickiness of valuation and of deliberate under-assessment. The nominal rateable value is thus different from the true rateable value and the nominal rate poundages are misleading.

To put things differently the percentage of rates to income, that is, the true burden of the local rates, is not necessarily reflected in the level of rate poundages especially the nominal poundages. In fact the nominal rate poundages may not be high while the burden of the rates is actually high owing to a high level of assessment. This can be exemplified (before the War) by the northern and southern areas, the former having a heavier burden of rates (i.e. rate/income proportion) but not very high rate poundages.

Conversely, the rate poundages may be high while the

burden of the rates is low owing to a low level of assessment (underassessment).

It is thus significant that while the average rate poundage increased much since 1938-39, the proportion of rates to income decreased owing to the increase in national income. In fact the average rate poundage was 12/4 in the pound in 1938-39, 19/4 in 1951-52, about 20/- in 1952-53 and may exceed 22/- in 1953-54. However, the proportion of rates to national income was less than 3 per cent in 1950 as against over 4 per cent in 1938.<sup>(1)</sup>

To sum up, the real burden of local property taxation in England is represented by the connection between the rates and income. This depends on two things, namely; the proportion between gross rent, including rates, and income, national or local, and depends also on the proportion of rates and net rent within the gross rent.<sup>(2)</sup>

We may now exemplify the general and local regressiveness of the "rates" in England and Wales using income.

#### A. General Regression:

Regressiveness is here measured, for the various income

(1) Chester, D.N. : "Local Finance".  
Lloyds Bank Review. July, 1951. p.34.

(2) Hicks, J.R. - Hicks, U.K. and Leser, C.E.V. : op.cit. p.2



groups, for the country as a whole.

The following table discloses the percentages and totals of the rates, referred to total income after income tax for the year 1937-38.<sup>(1)</sup> The results are of appreciative value.

#### Regression of the Rates.

Income Groups	Total Income After Income Tax £ millions	Proportion Paid in Rates	Total Sum Paid in Rates £ millions
Under £250	2676	3.8	101
£ 250 - 500	578	3.4	19
£ 500 - 1000	311	3.0	9
£1000 - 2000	224	2.0	4.5
£2000 -	340	1.0	3.5
	<u>4129</u>	<u>3.3</u> (average)	<u>137</u>

It is interesting to note the regressiveness among the working class and middle class, whether renters or owners. For the manual workers-renters the average burden was 2.7% and for the home-owners of the same class probably 3%.

- (1) Hicks, J.R. - Hicks, U.K. and Leser C.E.V. : The Incidence of Local Rates in Great Britain. National Institute of Economic and Social Research. Cambridge, 1945. p.46.
- (2) Income Tax in Great Britain. Statistical Series of the Oxford University Institute of Statistics. November and December, 1931. p.379.
- (3) Gilling, J.E.G. : "Income Estimates for Small Areas" in Local Government Finance, Journal of the Institute of Municipal Treasurers and Accountants. June, 1932.

Among the middle class renters the burden was 3.8% for income of £350, 3.5% for income of £400, 3.1% for income of £450. Among the home-owners within the same class, the rate-income function was 4.8% for income of £360 and 4% for income of £450.

#### B. Local Regression:

The burden of the local rates can be also estimated, within each local unit, by referring the rates to local income. This throws light on the real inter-area fiscal inequalities in a country like England where such divergencies are obscured by the rate poundages as will be seen below.

It is noteworthy that the income tax statistics in England do not afford a sound basis as income is not always taxed where it is earned. The computation of local income is thus fraught with difficulties. Some estimates were made for Bristol<sup>(1)</sup> and more recently for Oxford.<sup>(2)</sup> Better estimates are being made for Cambridge. An attempt to compute local income by regions was also undertaken by Miss P.M. Dean of the Department of Applied Economics in the University of Cambridge. It is to be hoped that further research will be carried out in this connection.<sup>(3)</sup>

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- (1) Ellis, A.W.T. : "Rents, Rates and Incomes in Bristol".  
The Review of Economic Studies. No.2, 1944. p.99.
  - (2) Lydall, H.F. : "Personal Incomes in Oxford".  
Bulletin of the Oxford University Institute of Statistics.  
November and December, 1951. p.379.
  - (3) Utting, J.E.G. : "Income Estimates for Small Areas" in  
Local Government Finance, Journal of the Institute of  
Municipal Treasurers and Accountants. June, 1953.

It is however possible, for England and Wales, to relate the rates to income in an indirect way through expenditures. This is a tenable assumption for the low-income earners as their propensity to consume is high.

The method was resorted to by Mrs. Hicks who computed the regressiveness of the rates for the working class in the different regions. The calculations are based on an October's week in 1937.

A general idea of intra-local regression can be given by the following table for some regions.

Gross and Net Rents and Rates as Percentage of  
Average Expenditures of all Households in the  
Group (Oct. 1937) (1)

Households with Average Expenditure Per Week Per Head of	London			South East			Wales		
	G.R. %	N.R. %	Rates %	G.R. %	N.R. %	Rates %	G.R. %	N.R. %	Rates %
Under 10s.	20.3	14.8	5.1	16.1	12.1	3.6	17.5	10.8	6.0
10s. - 20s.	18.8	13.7	4.8	15.2	11.5	3.4	14.2	8.8	4.9
20s. - 30s.	16.7	12.2	4.3	14.3	11.0	3.1	11.9	7.4	4.1
30s. and over	14.2	10.4	3.6	12.1	9.1	2.7	8.4	5.2	2.9
All Households	15.9	11.4	4.1	13.7	10.3	3.0	11.6	7.2	4.0

(1) Hicks, J.R. - Hicks, U.K. and Leser, C.E.V. :  
The Incidence of Local Rates. Op.cit. p.24.

### 3. Local Property Taxation and Progression:

#### A. Property Taxation and the Progression of the National Tax System:

An important fact must now be brought to light. The regressive structure of the imposts, including property taxes, of the lower tiers of government can exert an adverse effect on the progressive structure of the national tax system, especially when the minor taxes are substantial. The over-all tax system can thus be made less progressive, or even rendered regressive, for some or all income groups. In a federal polity this "induced national fiscal inequity" is more liable to occur and can be of importance (e.g. the U.S.A. before the Second World War).

An illustration is afforded, for Great Britain, by the following table for 1934-35 (which also discloses the regressiveness of the rates).



# Regressiveness of the Rates, and Rates

## Plus Direct Taxes

In the Low-Income Groups, 1951-52<sup>1</sup>

Gross Household Income £	Per cent of Gross Income		
	Rates %	Direct Taxes %	Rates & Taxes %
Under £ 100	10.4	0.1	10.5
100 - 199	6.8	1.8	8.6
200 - 299	4.2	4.8	9.0
300 - 399	3.3	5.4	8.7
400 - 499	2.8	5.9	8.7
500 - 599	2.4	7.0	9.4
600 - 699	2.3	8.2	10.5
700 - 799	2.3	10.0	12.3
800 - 899	2.2	12.0	14.2
900 - 999	1.9	12.8	14.7
1,000 - 1,499	1.9	16.1	18.0
1,500 - 1,999	1.5	23.2	24.7
2,000 and over	1.0	45.2	46.2
Total:	2.4	13.6	16.0

N.B.: Sample of 1,899 households.

1. Lydell, H.F. and Dawson, R.F.F.

"Household Income, Rent and Rates", Bulletin of the Oxford  
University Institute of Statistics, Oxford, April, 1954, p.111



# Regressiveness of the Rates and

## Rates Plus Taxes in the Low Income-groups

### For Manual Workers. <sup>1</sup>

#### 1. Manual Workers.

Gross Household Incomes £	Rates %	Direct Taxes %	Rates & Taxes %
Under 200	4.8	6.6	11.4
200 - 399	3.0	5.4	8.4
400 - 599	2.3	6.0	8.3
600 - 799	2.1	8.1	10.2
800 - 999	1.6	9.9	11.5
1,000 - 1,999	1.2	11.8	13.0

#### 2. Salaried and Self Employed.

Gross Household Income £	Rates %	Direct Taxes %	Rates & Taxes %
Under 400	3.6	6.5	10.1
400 - 599	3.0	7.2	10.2
600 - 799	2.8	10.0	12.8
800 - 999	2.5	15.0	17.5
1,000 - 1,999	1.9	21.0	22.9
2,000 and over	0.9	45.7	46.6

1. Lydall and Dawson: Op. cit., p. 117.

Sample of 1,899 households. Gross income (i.e. before Tax) for 1951-52.

The Tax Incidence as a Percentage of Income in  
Various Income Groups 1934-35. Income all earned.  
Married person with 3 children. (1)

Income £	65	100	150	225	335	500	750	1125	1675	2500	10000
(1) Direct Taxes (Income and surtax)	-	-	-	-	-	1.2	5.7	9.8	13.0	17.2	36.1
(2) Indirect Taxes.	9.9	9.8	9.5	7.6	5.2	3.6	2.8	2.3	1.9	1.7	1.2
(3) Rates.	7.2	6.8	5.3	4.4	4.5	4.3	3.9	3.3	2.8	2.5	1.8
<u>Total Burden</u>	17.1	16.6	14.8	12.0	9.7	9.1	12.4	15.4	17.7	21.4	39.1

N.B. : The indirect taxes comprise alcohol, tobacco, tea, miscellaneous food, sugar, entertainments. The rates are calculated in London, Southampton and Sheffield. The rates are assumed to be borne by the occupier and not shifted. This is justified by the relatively inelastic supply of houses during that period.

The table shows that the graduated scale of the central taxes feels the impact of the regressive local and outlay taxes. The outcome is a mitigated rate of progression in the national

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(1) Hicks, U.K. : The Finance of British Government, 1920-1936. London, 1938. p.277.



tax system which at some income-groups becomes openly regressive, as at the income groups 150, 225, 335 and 500.<sup>(1)</sup>

#### B. Progressive Property Taxation:

The principle of progression is not applicable, from the theoretical viewpoint, in the case of local property taxation whether the property taxes are based on rental value or capital value and whether they are payable by the owner or the occupier. As already pointed out, graduation can really only apply to total individual net income otherwise it leads to distortions of over-all fiscal equity.

In underdeveloped countries, however, progressive property taxation could eventually be justified on the ground that income from property is overwhelmingly important.

Illustrations of graduated property tax rates are afforded by some Swiss cantons,<sup>(2)</sup> and the Argentine provinces as will be expounded, in some detail, below. In Egypt, the land tax has been more or less "personalised" for the small property-owners.<sup>(3)</sup>

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(1) For the same point under discussion, see also: Simon, Shena D. : Local Rates and Postwar Housing. London, 1943. p.22.

(2) Buchler, Alfred G. : Public Finance. New York, 1948. p.340.

(3) In Australia and New Zealand there is an additional graduated tax imposed on the owners when the holdings exceed a specific exemption. See, Gilbert, James H.: The Tax Systems of Australasia. Eugene, Oregon University, 1943.



In England, it is interesting to refer to the fact that some writers advocate the resort to progression in local value property taxation. Mr. Sullivan states that:

"The rating system began long before the principle of progressive taxation - namely, that the rich should pay a larger proportion of their incomes in taxes than the poor - had become an integral part of our fiscal system, as it did on the introduction of income tax and death duties in the nineteenth century. There is no reason why the rating system should not be transformed into a progressive tax in the same way." (1)

It may be said that the present system in England actually bears some form of graduation. In fact the "gross value" is reduced by various percentages which vary inversely with the amount of "gross value" as shown in the following table:

Gross Value £	Deduction Allowed for Net Value
Under £10 per an.	40 per cent.
10 - 20	33 $\frac{1}{3}$ per cent (or £4 whichever is greater).
20 - 40	25 per cent or £7.
40 - 100	20 per cent or £10.
Over £100	£20 plus 16 $\frac{2}{3}$ per cent of gross value in excess of £100

(1) Sullivan, John : The Reform of the Rating System. (Foreword by W.A. Robson). Fabian Society, 1939. p.25.

Mr. Sullivan suggests a widening of the present system of percentage deductions from gross value. The rateable value would thus be reduced in inverse proportion to the gross value or size of the house.

Other proposals have been put forward such as relating the aforementioned deductions to the income-tax assesment of the ratepayer, the lower the latter the higher would be the rate of deduction. Another proposal consists in varying the poundage rate according to the rent per head (excluding servants) in direct proportion. The higher the latter the higher would be the rate poundage. Furthermore, it is suggested to relate the rate poundage to the size of the house or the income-tax assessment of the ratepayer.<sup>(1)</sup>

These devices of differential rating, in so far as they are attempts to introduce an element of progression in the rates, fail to reach the core of the problem, namely the inherent regressiveness of local property taxation.

Moreover, it is the writer's opinion that if these attempts are pushed too far, more prejudice than good may be done to the rational progressive structure of the all-inclusive tax system.

#### C. The Argentine Experiment: : "Argentine Provincial Tax Systems". The American Economic Affairs, Winter, 1953. p.57.

The developments in Argentine provincial property taxation

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- (1) Silver, A.N. : The Reform of Local Government Finance.  
London, 1945. p.54.

during the last thirty years, provides considerable <sup>instruction</sup> with regard to "personalisation" in general and graduation in particular. (1)

The reforms pertain to the application of progressive tax rates <sup>in general</sup> and additional rates for absentee owners. (2) Recharges or penalties may be also imposed on large holdings. Further distinctions, in the level of the rates or the scale of graduation, may be made between urban and rural property, between occupied, partly-occupied and unoccupied properties, between individual and corporate property or between small and large areas. Homestead exemptions, total or partial, and exemption of improvements are sometimes provided for.

These new features are noticeable, in varying degrees and different combinations in many provinces such as Córdoba, Salte, Santa Fe, Entre Rios, Buenos Aires and others. Some illustrations could be given.

In the Province of Córdoba, rural property is taxed at 4 $\frac{1}{2}$ % per 1,000 pesos valuation for properties up to 5,000 pesos and reaches to 20% per 1,000 pesos for properties valued over 3,000,000 pesos. The additional tax for absenteeism ranges

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(1) Patterson, Ernest F. : "Argentine Provincial Tax Systems". Inter-American Economic Affairs. Winter, 1953. p.37.

(2) The Argentine property tax rates are expressed as a per cent per 1,000 pesos valuation.

(3) Patterson, Ernest F. : Op. cit. p.42.

from 1% to 6% per 1,000 pesos valuation according to different classifications of property values.

If urban property is subject in Cordoba, to a proportional rate of 7% per 1,000 pesos valuation, in the Province of Salta the rates begin at 2% per 1,000 pesos valuation for properties valued at 10,000 pesos or less and reach to 20% per 1,000 pesos for properties valued over 10,000,000 pesos.

The Provinces of Santa Fe and Entre Rios take into consideration the area of rural properties for which additional rates are provided varying according to categories of hectares. In the Province of Entre Rios, therefore, the basic rates begin at 4% per 1,000 pesos valuation for properties up to 13,000 pesos and attain 25% when the value of the property is above 1,950,000 pesos. The additional tax rates, affecting a progressive scale, begin at 2% per 1,000 pesos valuation for areas between 1,000 and 2,000 hectares and reach to 15% for areas above 20,000 hectares.<sup>(1)</sup>

#### 4. Fiscal Equity and Shifting:

The "effective incidence" of local property taxes, as distinct from their "formal incidence" can result in the tax falling on other persons. The effects, as concerns ability to pay and fiscal equity, depend on the pattern of the local tax

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(1) Patterson, Ernest F. : op. cit. p.42.



and on the direction of shifting whether it is forward or backward.<sup>(1)</sup>

If the local property tax, based on rental value, falls on the owner, the latter may shift an increase in tax forward to the renter-occupier in higher rents and/or quantitatively/qualitatively reduced services such as repairs. The shifting depends on various factors notably general economic conditions. In periods of prosperity and in expanding areas, the shifting is easier. The shifting is easier still if the supply of the durable consumption goods, or houses, is relatively inelastic owing, for instance, to long-term productive investment planning or various restrictions on raw materials generated by hot or cold war economics. The outcome of forward shifting, in this case, militates against fiscal equity.

Conversely, during recession and within declining areas, an increase in the house tax falling on the owner is not easily shiftable forward and the result is more in line with the ability principle.

If the formal incidence of the local house tax falls on the

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(1) Mrs. Hicks explains "effective incidence" as a comparison between two pictures, "one of the economic set-up (distribution of consumers' wants and incomes and allocation of factors), as it is with the tax in question in operation; the other of a similar economic set-up, but without the tax."

Public Finance, London and Cambridge, 1947. p.159.

occupier, as is the case in England, an increase in the tax, or "rates", when occurring in depression or declining districts, will tend to be shifted backward to the owner.<sup>(1)</sup> Such shifting militates in favour of ability to pay. connection,

Conversely, in periods of expansion or full employment, a rise in the rates is not susceptible of backward shifting and the effective incidence falls on the occupier. The local regression will be thus still manifest.

It is noticeable that in times of brisk economic conditions, a fall in the nominal rates may lead to an increase in rents. Mrs. Hicks states:

It is also to be mentioned that shifting is not possible in some cases especially rent control and the municipally subsidized houses. in it. (3)

#### Overview:

Regressiveness is inherent in the local taxation of property. It cannot be coped with by rent control or municipal subsidization of new buildings. The substitution of other taxes for the rates, for instance local income taxation, site value taxation, is by no means an easy proposition. Various implications, tackled in due course, are not to be

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(1) Hicks, J.R. - Hicks, U.K. and Leser, C.E.V. :  
The Incidence of Local Rates.

overlooked. We feel the duty to underline, here, the regressive impact of local property taxation in general and the English pattern in particular.

Professor G.D.H. Cole may be quoted in this connection, "Indeed, I should dearly like to be able with a good conscience to propose the abolition of local rates and the substitution for them of some less inequitable form of local taxation."<sup>(1)</sup>

Similarly, the supporters of local property taxation, on grounds of practicability and inevitability, feel the need for reforms. Mrs. Hicks states:

"We believe that the rating system has to be preserved, and therefore ought to be reformed, however arduous a matter it may be to reform it."<sup>(2)</sup>

In sum, the accurate criterion of the discrepancies in the incidence of the rates is the relation rates/income (or rates/expenditures) and not the rate poundages. Having borne this cardinal fact in mind, we may now proceed to a review of the various factors which account for both the true and apparent inter-area disparities in the burden or level of the rates (which disparities are not due to differences in local

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(1) Cole G.D.H. : Local and Regional Government. London, 1947. p.223.

(2) Hicks, J.R. - Hicks, U.K. and Leser, C.E.V.: The Problem of Valuation for Rating. p.6.

## 2. Inter-Local Fiscal Inequalities.

An estimation of the extent of the inter-area divergencies in the incidence of the rates should be based, not on the rate poundages, whether true or nominal, but on the relation between the rates (as any tax) and local income. In view of the difficulties of computing the latter, it is possible to refer to expenditures as an alternative. This indirect method is notably reasonable for the low-income brackets where savings are not likely to be high. A table quoted above illustrates some inter-area differences (before the War).

In sum, the accurate criterion of the discrepancies in the incidence of the rates is the relation rates/income (or rates/expenditures) and not the rate poundages. Having borne this cardinal fact in mind, we may now proceed to a review of the various factors which account for both the true and apparent inter-area disparities in the burden or level of the rates (which disparities are not due to differences in local services).<sup>(1)</sup>

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(1) Professor Cannan enumerates various causes for the inequalities of rates, inter alia, the difference in local services and their costs, the differences in the return from local capital investment, differences in costs of poor relief and efficiency of administration. This explanation is over-simplified and confusing. It omits important factors and includes others which ought to be isolated. See, Cannan, Edwin : "Inequalities of Local Rates and its Economic Justification." The Economic Journal, March, 1895. p.22.



under-privileged areas, with low true rateable value will have high true (as opposed to nominal) rate poundages while the richer local units with high true rateable value will have low true rate poundages.<sup>(1)</sup>

In the poor areas, another reason for the high rate poundages, besides the low rateable value, is the relatively higher costs of the same amount of services. While the rise in rate poundages due to general changes affect all the local units uniformly, this is not the case when the increase in rate poundages is brought about by the general expansion in local services since the latter may not only be unequally distributed interlocally<sup>(2)</sup> but will also have varying local implications regarding costs.

## 2. Valuation:

Valuation, in England, is a source of inter-local differences in rate poundages. Two points may be mentioned in this connection, namely, the stickiness of valuation and under-

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- (1) The ratio, within a given locality, between the actual amount of rates paid and the true rateable value of the house gives the true poundage. If the nominal rateable value is substituted for the true rateable value we get the nominal poundage. See:

Hicks, J.R. - Hicks, U.K. and Leser, C.E.V.:

The Problem of Valuation for Rating. p.49.

- (2) In general, expenditures are more pressing in poor areas than in more prosperous ones (however they rise more in the most wealthy areas).

valuation.

The general slackness in valuation based on rental value has been already pointed out. It is accentuated by increases in income and prices as happened in 1914-20. If the degree of stickiness were uniform all-over the local units this factor would not be responsible for the inter-local disparities in rates. However, the operation of valuation is not centralized. Moreover, prices and actual rents may increase in certain areas relatively more than in others. This is noticeable in expanding areas as opposed to stagnant or less developing local communities. Similarly, the control of rents results in lower levels of assessment in wealthy localities owing to the quicker development of construction there.

As for undervaluation, it is causative of rate disparities in so far as it is practised in a non-uniform way.

It ought first to be noticed that there was a general tendency for undervaluation in expanding areas for both old and "new" houses. In other words, "the degree of undervaluation of all houses, whether old or new, was smallest in the poorer areas and largest in the wealthier."<sup>(1)</sup>

In fact, underassessment is expensive and cannot be afforded by under-endowed localities.

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(1) "Rates and Values", in, The Times. May 20, 1953. p.9.

(1) The level of assessment is the ratio between nominal and true rateable value (or nominal and true poundage).

The special underassessment of "new" houses (built after World War I) is a further cause of disparities in poundages. The percentage of "new" houses is, indeed, smaller in poor or contracting localities and larger in more prosperous areas.

To sum up, the low level of assessment<sup>(1)</sup> is a feature of wealthy areas which have a high rateable value (per house) and low rate poundages. Conversely, the high assessment level characterizes poorer local communities with low rateable value and high rate poundages.

These reasons account for the fact that the uniformisation of valuation is likely to increase, rather than mitigate, the disparities in rate poundages.

The effect of the variability in valuation practices can be appreciated by a comparison, considering a number of districts, wealthy and poor, between the dispersion of the nominal rate poundages and the dispersion of the true rate poundages; both categories of poundages being expressed as ratios to the average (nominal or true) poundage for the totality of the areas under consideration.

It will be found that the dispersion of the true poundages is wider.

Another method, conducive to the same result, consists in computing, in the various areas, the specific average nominal

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(1) The level of assessment is the ratio between nominal and true rateable value (or nominal and true poundage).

and true poundages expressed as a percentage of the general average, nominal and true respectively. (1)

The Dispersion of Nominal and True Rate Poundages  
in a Certain Number of Areas, 1938. (2)

(The Average for nominal poundage was 12s.11d. and for true poundage was 8s.9d.)

	No. of Districts With Nominal Poundage	No. of Districts With True Poundage
60-40% Below Average	1	4
40-20% " "	33	36
Less than 20% Below Average	81	74
Less than 20% Above Average	56	37
20-40% Above Average	20	24
40-60% " "	12	11
60-80% " "	5	6
80-100% " "	6	6
100-120% " "	4	3
120-140% " "	-	9
140-160% " "	-	3
160-180% " "	-	1
180-200% " "	-	1
200-220% " "	-	1
220-240% " "	-	2
	218	218

- (1) Hicks, J.R. - Hicks, U.K. and Leser, C.E.V.:  
The Problem of Valuation for Rating. pp.48-53.
- (2) Hicks, Hicks and Leser : op. cit. p.50



### 3. Derating:

The total exemption of agricultural hereditaments and the partial exemption of industrial hereditaments in 1929 cannot be overlooked as a source of tax differentials since the proportion of both these tax subjects to residential property and small shops, that is, the residual tax subject, varies between localities of the same category.

The rateable value, and hence the rate poundages, thus necessarily undergo changes in varying proportions between the local units of the same class.

Clearly, the derating of agricultural, industrial and transport hereditaments involves discrimination against residential buildings, commerce and service trades<sup>(1)</sup> which is not desirable from the fiscal equity viewpoint and is not agreed to by the writer who recommends rerating for further reasons.<sup>(2)</sup>

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(1) Commercial properties, at present time, form the following proportions of rateable value; L.C.C. 37.1%, County Boroughs 23.2%, Counties (excluding London) average 12.7% or 14.7% in urban areas and 6% in rural areas. See, Chester, D.N. : "Analysis of Rateable Value of England and Wales, 1st April, 1952." Local Government Finance. Jan., 1954. p.14.

(2) See Chapter III on "Revenue Inadequacy." Measure of Ability, in Viewpoints on Public Finance, edited by Harold Groves. New York, 1947. p.50.

### III Fiscal Equity and Local Property Taxation On Capital Value

#### 1. Inequities and Inequalities:

In some countries, the lower tiers of government tax property on the basis of its capital value instead of its annual rental value. The reason is often one of historical development. Where land was scarce, as in Europe, it was seldom sold and its yield focussed attention more than its market value. Where land was abundant, as in America, it was more freely bought and sold and its capital value was its prominent feature.

We saw that there is little connection between property and ability to pay. To tax the property owner on the capital value of his property instead of its annual rental value is no better solution.<sup>(1)</sup> Real property is only an item in one's wealth and can only be brought within the scope of the tax system as an element of total net income. Moreover, serious fiscal inequity arises if real property is taxed in one locality according to situs and in another according to the

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(1) Heer, Clarence : The Property Tax as a Measure of Ability, in Viewpoints on Public Finance, edited by Harold Groves. New York, 1947. p.50.

residence of the owner. Clearly inter-personal injustice arises unless both the resident owner and the non-resident owner are taxed on both the objective basis and the ownership basis.

If the local property tax is not confined to lands and buildings but is extended to personal property as well, fiscal inequity becomes even more flagrant. Such a tax disregards the differences in the earning power of property. If farms and machines have an earning power, household furniture has none. Farms, forests, manufacturing machinery, merchandise have widely varying degrees of earning power.

If the property tax is further extended to intangible property, tax injustice assumes more serious proportions. In spite of the fact that intangibles (e.g. bonds, stocks, mortgages, bank deposits) are largely owned by the high income-receivers, their taxation cannot be justified on grounds of ability. They have no separate ability from the wealth they stand for. They represent wealth already taxed and lead to multiple taxation. Moreover, intangibles vary in their income yielding capacity. Some yield income, some do not. They fluctuate much in their yields from year to year according to endogeneous or exogeneous factors.

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- (1) Girard, Richard A. : The Scope for Uniformity in State Tax Systems. Special Report of the State Tax Commission No.8. New York, 1935. p.57.

The possible duplicity of tax burden can be illustrated by an example from the United States. A buyer's a property with a cash payment. B buys another property of equal value and net annual income, part in cash and part with a mortgage. Both property owners will be subject to tax on the full original value of the property. If the rate of the tax is flat and is equal on tangibles and intangibles, the second property owner will pay more than the tax paid by the first as the income which B derives from his property pays the full tax on his property and the tax paid by the holder of the mortgage (the latter pays tax out of income derived from B's property).<sup>(1)</sup>

	<u>Real Estate Tax (at 3%)</u>	<u>Intangibles Tax (at 3%)</u>	<u>Total Property Tax</u>
A	\$ 300	-	\$ 300
B	\$ 300	-	\$ 450
C's mortgage on B's property.	-	\$ 150	

Obviously the way out of this duplication lies in either simple cancellation of the tax on intangible property, or the

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(1) Taylor, Philip, E. : The Economics of Public Finance. New York, 1948. p.358.

See also:

Jensen, Jens P. : Concepts of Taxable Property. in Viewpoints on Public Finance. Edited by Harold Groves. New York, 1947. p.40.



extension of the latter to all rights to wealth whether represented by documents or not (in other words uniform duplicate taxation). This can be illustrated by the following example.<sup>(1)</sup>

	Real Estate Tax. $1\frac{1}{2}\%$	Intangibles Tax. $1\frac{1}{2}\%$	Total Property Tax
A's farm	\$ 150	-	\$ 300
A's equity in his farm		\$ 150	
B's farm	\$ 150	-	\$ 300
B's equity in his farm	-	\$ 75	
C's mortgage	-	\$ 75	

If the inclusion of intangibles in a comprehensive system of property taxation leads to multiple taxation, it may also open the door to evasion and hence inter-personal fiscal inequalities. Intangibles may be subject to different tax burdens in different localities. They may be taxed in a locality and exempted in another. Consequently, they can be moved from a local unit to another. More simply still, they can be concealed. The latter problem is particularly acute in the U.S.A. Prof. Jensen reveals that, "Intangible property is declared for taxation by those who are exclusively honest, by

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(1) Taylor, P.E. : op. cit. p.359

those who are temporarily or permanently ignorant, and by those who (like the tradition<sup>al</sup> of widow and orphan) are unfortunate enough to have their property publicly recorded." (1)

This fact is expressively rendered by the statement of the Mississippi Legislative Committee of 1918 that property tends "to impose burdens with reference to inability to escape, rather than in proportion to ability to pay."

Clearly, the outcome of evasion is that the taxation of intangibles, which form a high percentage of the wealth of the high income-receivers, leads to regressiveness.

Another important source of fiscal inequity stems from the assessment of property, whether real or intangible. A discrepancy will emerge, in a dynamic economy, between the true market value and the assessed value of the property, especially if the valuation is undertaken sporadically or is sheerly conventional, that is carried out by non-experts. In the U.S.A. about 90 per cent of the assessors are popularly elected and are often local politicians with no qualifications.

Assessment, as a source of fiscal inequality and inequity, can be better studied with reference to a specific country. Let us take the U.S.A. where the problem is particularly

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(1) Jensen, Jens P. : "Survey of Colorado State Tax System" (Denver Chamber of Commerce) 1930. p.81.

entangled. to be residential. As the true value of property

There are three bases of valuation: capitalisation of current income, appraisal of the present value of anticipated future income and the market prices at which similar properties are the object of transactions. In a static economy these three values can be identical. In a dynamic economy they diverge. If the township assessments are the

From the legal point of view, property in the U.S.A. is assessed according to its fair market value. Clearly, divergencies make their appearance between the capitalisation of current income and the present fair market value or the prospective income. This often occurs on the fringe of expanding cities. Prof. Groves gives the following example.<sup>(1)</sup> A rents a piece of vacant land for \$ 15 a year. The capitalisation of current income at 5% gives a value of \$ 300. However, the land may be subject to property tax on the basis of a value of \$ 20,000 on the ground that the owner could get that price now if he sold his property for business or residential purposes. property is assessed at 40 per cent of the

If over-assessment is considered by some as the main source of fiscal inequity,<sup>(2)</sup> under-assessment is another

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(1) Groves, Harold M. : Financing Government.  
New York, 1945. p.67.

(2) Shipley, Federic B. : "Is Real Estate Taxed Excessively and Inequitably." in Current Problems in Public Finance.  
New York University, 1933. p.73.

source not to be neglected. As the true value of property cannot be easily reached, it is often safer for the assessor to guess a lower value in order to avoid litigation. The elected assessor may be trying to gain favour. The taxing jurisdiction may be trying to compete with another. Competitive under-assessment is an important factor in small assessment districts. If the township assessments are the basis of county levies, the assessors in the former may resort to under-assessment in order to reduce the taxes which his constituents will be called to pay to the county or state.<sup>(1)</sup>

Owing to the disparity between property ownership and ability to pay some attempts have been made to classify the various types of property, of varying earning power, and to subject each class to an appropriate treatment. The differentiation is based on either the application of different tax rates or some deliberate under-assessment.

Now, the main problem about under-assessment, as far as fiscal equity is concerned, is the fact that it is not carried out uniformly. Some property is assessed at 40 per cent of its "fair" value, some at 60 per cent, some at 100 per cent. In fact, if all property were assessed at full market value, the capacities to pay per dollar of assessed value of all property

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(1) Snider, Clyde F. : American State and Local Government. New York, 1950.



would be equal.<sup>(1)</sup>

In connection with assessment, it is noticeable that, in the U.S.A., property of a small value is often assessed at a higher proportion of its "true" value in comparison with properties of <sup>higher</sup> great value. The reason is probably that smaller property is better known or because the wealthy owners can use their influence.<sup>(2)</sup> The result is, clearly, more regression and less fiscal equity.

This fact has been ascertained in many American states. Silverherz gives figures for Maryland:<sup>(3)</sup>

Value of Property	R u r a l		U r b a n	
	Number of properties	Average assessment ratio	Number of properties	Average assessment ratio
Under \$ 1,000	522	92.1	1,195	76.2
\$ 1,000 - 5,000	1,675	76.4	1,897	61.2
Over \$ 5,000	705	56.7	289	54.5

- (1) Buchler, Alfred G. : Public Finance. New York, 1948. p.350.  
Taylor, P.E. : op. cit. p346 & 352.
- (2) Groves, Harold : Financing Government. New York, 1954. p.69.
- (3) Silverherz, Joseph D. : The Assessment of Real Property in the United States. Special Report of the State Tax Commission No.10, State of New York. 1936. p.69.

Although regressiveness of this nature was found mild in a few states e.g., Indiana and Iowa, the author concludes, "But the majority of the tests coincided in their finding that there was a definite and pronounced tendency for the average assessment ratio to decline as the value of the property (or value per acre, when this was used as the basis of classification) increased."<sup>(1)</sup>

Rigidity of assessment in the U.S.A. is a source of further inequality. Oftentimes, the assessment is either copied from the previous year without any change or uniform percentages of increase or decrease are adopted with no regard to inter-personal or inter-group value fluctuations.

To sum up, assessment in the U.S.A. leads to various types of inequalities.<sup>(2)</sup>

1. Inequalities Among Individual Properties: In fact the differences in the treatment of individual properties, is the essence of the problem. The average degree of this kind of inequality is measured by the coefficient of dispersion. The following table shows how pronounced the inequality is in the case of Florida among other states.

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(1) Silverherz. op. cit. p.213

(2) Silverherz. op. cit. p.209-219.

State	RURAL Coefficient of Depression.	URBAN Coefficient of Depression.	ALL
Pennsylvania	35.53	32.2	44.26
Virginia	44.43		
Florida	69.60	68.92	
Texas	48	49	
Oregon	50.26	48.00	

2. Inequalities Among Group Averages: This arises amongst average assessment ratios of various types of properties,<sup>(1)</sup> for instance rural and urban, resident and non-resident owned property, land and improvement, inter-district or inter-class.

State	Year	Rural	Urban
New York	1915-25	49.1	63.6
Pennsylvania	1923-25	49.8	40.3
Maryland	1927-32	91.5	66.8
Arkansas	1921-25	35.0	56.0

- (1) Silverherz defines "assessment ratio" as a percentage figure which represents the relationship between the value of a property and its assessed valuation. If the property is worth 10,000 and assessment is 7,000 the assessment ratio equals 70 per cent. The "average" assessment ratio" is an average of the assessment ratios of a number of properties. op. cit. p.16-17.

3. Inter-Area Inequalities: The following table discloses the inequalities between local units.<sup>(1)</sup>

State	R u r a l		U r b a n	
	Types and numbers of localities	Inter-Area Differences Coefficient	Types and numbers of Localities	Inter-Area Differences Coefficient
Massachusetts	8 towns	12	-	-
New Jersey	16 counties	16	-	-
Maryland	6 "	9	6 counties	7
Florida	10 "	51	10 "	43
Washington	39 "	21	39 "	17
Missouri	39 "	16	39 "	13
Texas	8 "	29	7 "	12

It is noticeable that Florida exhibits glaring inter-area inequalities. Important inequalities are also found in the case of Washington and Texas.

(2) Especially after so many exemptions have been provided for homestead and private property, for charitable, educational or religious purposes.

(1) Silverherz, J.D. : op.cit. p.212

See also:

Morton, Walter A. : "General Property Taxes Found Very Regressive." in The Municipality (Wisconsin League of Municipalities) February, 1946.



## 2. Degree of Regression of the American Residential Property Tax:

The American tax is no more a "General Property Tax". It is more confined to real property. Intangibles are less and less taxed. The same occurs with personal property, tangible or intangible. This is a most fortunate tendency as it helps to mitigate the glaring effects of a tax on the capital value of property as a whole.

It is noticeable that residential property now accounts for a high percentage of the American property tax.<sup>(1)</sup> In Wisconsin, one of the few states having accurate statistical evidence, the assessed value of residential property amounted to 45.1 per cent of the assessed value of all local property.

In the majority of states, the tax rates have been increasing since World War I (with the exception of the Great Depression period).

Jesse V. Burkhead computed the regressiveness of the American residential property tax.<sup>(2)</sup> He chose samples of families living in owned and rented houses in six areas :

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- (1) Especially after so many exemptions have been provided for homestead and private property, for charitable, educational or religious purposes.
- (2) Burkhead, Jesse V. : "Property Tax as a Burden on Shelter" Article published in: The Journal of Land and Public Utility Economics (University of Wisconsin) August, 1944 p.255.  
See also:  
Morton, Walter A. : "General Property Taxes Found Very Regressive." in The Municipality (Wisconsin League of Municipalities) February, 1940.

- (1) Chicago, Illinois
- (2) Providence, Rhode Island
- (3) Columbus, Ohio
- (4) Omaha, Nebraska and Council Bluffs, Iowa
- (5) Three middle-sized cities in the East Central Area
- (6) Five small cities in the East Central Area.

Burkhead relates the tax burden to family-income classes (and not individual income). The tax is assumed to be fully borne by the occupants (i.e. the owners or renters, in the latter case the tax being fully shifted by the landlord to the tenant).

The first table below clearly shows how regressive the tax is on the low income-receivers.

The second table is more expressive in that it compares the regression of the property tax on residence with the regression of the sales tax, and also in that it expresses the regression by indexes.

[illegible]

(1)

Burden of Property Taxes on Residences by Income Classes 1935-36

(Taxes as a percentage of income on owned and rented homes.)

Class (ant)	Chicago		Providence		Columbus (a)		Omaha - Council Bluffs		East Central 3 middle- sized cities		East Central 5 small cities	
	Owned	Rented	Owned	Rented	Owned	Rented	Owned	Rented	Owned	Rented	Owned	Rented
9	-	-	-	-	-	-	-	-	12.05	6.01	11.83	5.11
9	11.23	5.89	-	4.94	5.75	3.30	3.85	4.44	6.65	4.25	5.91	3.95
9	4.92	4.99	5.19	4.42	4.79	2.77	5.16	3.78	5.85	3.66	5.06	3.28
249	6.85	4.21	4.84	4.05	3.44	2.42	4.26	3.52	5.15	3.51	4.69	3.04
499	4.92	4.22	5.66	3.52	3.14	2.17	3.59	3.06	4.57	3.06	3.60	2.66
749	4.57	4.00	4.61	3.49	2.81	2.25	3.45	3.04	4.20	2.97	3.42	2.75
999	4.23	3.88	4.83	3.14	2.55	1.90	3.56	2.80	3.49	2.97	3.60	2.59
2499	3.84	3.69	4.90	3.23	2.64	1.85	3.21	2.65	3.45	2.93	3.05	2.29
4999	3.77	3.51	4.35	3.02	2.27	1.85	3.04	2.91	2.94	2.94	2.66	2.26
9999	3.82	3.46	3.73	3.10	2.09	1.61	3.01	2.50	3.41	2.90	2.70	2.33
49999	2.69	3.12	4.23	3.00	2.12	1.56	2.92	2.71	3.31	2.56	(b) 2.39	(b) 1.75
99999	3.02	3.13	3.28	2.80	2.22	1.45	2.59	2.19	3.08	2.69	-	-
499999	2.45	2.82	4.81	2.79	1.98	1.50	2.63	2.55	2.78	2.23	-	-
949999	2.79	2.52	3.48	2.17	1.66	1.23	2.63	1.64	(c) 2.68	(c) 1.83	-	-
999999	(d) 2.29	(d) 2.53	(d) 3.52	(d) 1.88	(d) 4.01	(d) .71	(d) 1.72	(d) 1.10	-	-	-	-
10-over	2.12	-	-	-	-	-	-	-	-	-	-	-

Notes: (a) White families. (b) Income Class \$ 3,000 and over.  
 (c) Income Class \$ 5,000 and over.  
 (d) Income Class \$ 7,000 and over.

Regression of the Property Tax (on Residences) and Sales Tax  
1935-1936. (1)

Three Middle-Sized East Central Cities

(all taxes assumed to fall on the occupant)

Income Class \$	Average Family Income \$ (a)	Owned Homes		Rented Homes		Index of Regressivity Average per cent of income = 100		
		Taxes Paid \$	Per cent of Income	Taxes Paid	Per cent of Income	Taxes on Owned Houses	Taxes on Rented Houses	Sales Tax
0-499	435	52.40	12.05	26.16	6.01	265	189	160
500-749	669	44.50	6.65	28.41	4.25	146	134	126
750-999	895	52.40	5.85	32.73	3.66	129	115	122
1000-1249	1,134	58.40	5.15	39.78	3.51	113	110	112
1250-1499	1,364	62.40	4.57	41.70	3.06	101	96	109
1500-1749	1,608	67.60	4.20	47.68	2.97	93	93	104
1750-1999	1,870	65.20	3.49	55.49	2.97	77	93	97
2000-2249	2,120	73.20	3.45	62.15	2.93	76	92	97
2250-2499	2,372	69.80	2.94	69.74	2.94	65	92	92
2500-2999	2,739	93.30	3.41	79.51	2.90	75	91	86
3000-3499	3,218	106.60	3.31	82.26	2.56	73	81	82
3500-3999	3,701	114.00	3.08	99.47	2.69	68	85	80
4000-4999	4,414	122.80	2.78	98.42	2.23	61	70	73
5000 & over	6,732	180.10	2.68	123.46	1.83	59	58	57

Notes: (a) includes non-money incomes from owned houses.

(1) Burkhead, Jesse : op. cit. p.259



### 3. Ability, Progression and Local Property Taxation on Capital Value:

The principle of progression cannot be generally resorted to in property taxation, especially when the latter is based on capital value.

In the U.S.A., where exist the prototype of the latter mode of property taxes, the rates are mostly proportional and are uniform within the same local unit.

It is not possible to speak of "the" American property tax because there are almost as many property taxes as there are states. The main thing is that they are levied at rates which are uniform for the same property within the same area. The different minor jurisdictions may tax at different rates.<sup>(1)</sup>

The proportional structure may be affected by valuation, exemptions or classifications of property. However, the tax rates assume the form of percentages.

There have been attempts in Oklahoma and the Great Plains to impose a graduated land tax. The purpose was generally to break up big estates. However, other measures could be adopted to attain this objective.

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(1) Buehler, Alfred G. : Public Finance. New York, 1948. p.340.

## SECTION II.

### Local Personal Income Taxation.

#### Introduction

Fiscal equity, in the framework of central-local relations, can be adversely affected by the subjection of personal income to taxation, on the local level. Whether in unitary or federal countries local income taxes have been in use, or are still applied, by junior authorities.

The local income tax was the main source of revenue for the communes in Holland before 1930. They are also resorted to in Scandinavian countries and Finland. In Norway, in 1937, local income taxes amounted to 78 per cent of all taxation in the towns and 82 per cent in the rural districts.

In England, some writers advocate the application of local or regional income taxation in order to avoid the anomalies of the rates and to meet the increasing requirements of the local bodies.<sup>(1)</sup>

As for the federal countries, the local income tax

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(1) Cole G.D.H. : Taxation in Canada. Toronto, 1931. p.26  
Local and Regional Government. London, 1947. p.225

assumed, or still plays, an important role. In Germany, before 1919 it was a substantial local source of revenue especially in wealthy and densely populated states such as Saxony and also in many municipalities where it sometimes formed 90 per cent of their tax revenue.<sup>(1)</sup>

At present time, the income and corporation taxes form the principal source of revenue of the Länder. The latter share, with the Federal Government, 62% of these taxes (60% in the estimates for the budget of 1954-55).

In the Union of South Africa, the provinces made an extensive use of local income taxes from 1922 to 1925.<sup>(2)</sup>

Similarly, the Swiss cantons, enjoying great autonomy, resort to local income taxes.

In Canada, while only three provinces levied income taxes in 1930 (Prince Edward Island, Manitoba, British Columbia), by 1939 seven provinces were levying them.<sup>(3)</sup>

Owing to constitutional obstacles, in the U.S.A., the state personal income tax was not known before 1911. Moreover, there was no pressing need for it. State income taxation,

(1) Newcomer, Mabel : Central and Local Finance in Germany and England. New York, 1937. pp.28-30.

(2) Adarkar, B.P. : The Principles and Problems of Federal Finance. London, 1937. p.163.

(3) Perry, Harvey : Taxation in Canada. Toronto, 1951. p.26

however, gained ground. Two waves are discernible, namely during 1911-1921 and after 1928. The American municipalities were also induced to adopt the same mode of taxation owing to the expansion of services and increase in costs.

Philadelphia was pioneer in 1940.<sup>(1)</sup>

The fiscal inequities and inequalities, involved in local income taxation, assume increasing proportions when the junior non-taxing jurisdictions adopt income taxes or when the income-taxing jurisdictions, pressed by expanding expenditures, widen the scope of their taxes, or apply a graduated scale instead of proportional taxation or intensify the scale of local graduation.

The latter tendencies may be exemplified by the U.S.A. About ten years ago the maximum rate in the states was 5 per cent. At present, more than half of the states have maxima above 5 per cent. In North Dakota, the rate may now reach 15 per cent on income above \$ 15,000. Furthermore, progression is more and more extended to higher income brackets. It often reaches the \$ 10,000 level and in one state reaches even the \$ 250,000 level.<sup>(2)</sup>

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(1) See next Chapter on "Overlapping and Multiplicity", Section I and Section III.

(2) Blakey, Roy G. and Johnson, Violet : State Income Taxes. New York, 1942. p.33.  
State personal income taxation yielded 233 millions in 1941, 418 m. in 1947 and 499 m. in 1948. See:  
Kimmel, Lewis H. : Taxes and Economic Incentives. The Brookings Institution. Washington, 1950.



## I. Intra-Local Fiscal Inequity.

The fiscal inequities, generated within the same local unit, may be due to the imposition of regressive or repressive taxation or to some unfair local definition of income. The taxation of gross income or the absence of personal and family allowances in certain cases militate against fiscal equity as one should not pay tax on income whose marginal utility is infinite.<sup>(1)</sup> The exemption from taxation of certain flows of income may also conduce to inequities between local residents such as the exclusion of the instrumentalities of the central government especially in federal countries (e.g. U.S.A. before the Public Salary Act of 1939).

Two major sources of inequities may be outlined here. They are connected with interjurisdictional incomes and the partition of ability to pay.

### 1. Interjurisdictional Incomes, or Residence Versus Situs:

The junior taxing jurisdiction may adopt one of three courses in the taxation of income. It may adopt the basis of situs, or origin of income, according to which it taxes all persons, whether residents or non-residents, on income deriving within the local unit. The minor authority may prefer the basis of residence according to which all persons, residing

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(1) In the U.S.A. the state of Tennessee as well as the municipalities do not provide for allowances. See: Snider, Clyde F. : American State and Local Government, 1950. p.567

within the local area, will be taxed on all individual income from whatever source. The underlying authority may also combine both bases and tax residents on all individual income and also the income originating locally and accruing to non-residents.

The co-application, on the local level, of the principles of residence and situs is conducive to fiscal inequities either intra-local or inter-local. We are concerned here with the former which may be exemplified in various ways.

If the locality proceeds to taxation according to origin or situs, the local residents owning domestic income will be subject to taxation while their neighbours, living within the same local unit, owning property in another non-taxing locality, escape local taxation altogether. The same result obtains if the other localities tax according to residence instead of situs. Discrimination is thus noticeable.<sup>(1)</sup>

On the other hand, in the case of a residence-taxing locality, inter-personal fiscal inequity, in its intra-local aspect, may manifest itself if some local residents derive all their income within their taxing jurisdiction while their co-residents derive part of their income inside and part outside the locality, the outside taxing locality or localities applying the basis of situs. The co-resident income-receiver

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(1) In the U.S.A., instances of non-personal-income taxing states are Florida, New Jersey, Ohio.  
See Kimmel, Lewis H. : op.cit.

(in the residence-taxing locality) is thus victim of a heavier fiscal burden due to multiple taxation.

If the junior authority taxes its residents on all the income but not the non-residents on income originating within its boundaries, the non-residents escape taxation if their locality of residence is a non-taxing one. There is intra-local discrimination in the residence-taxing-locality, in the sense that some local income is subject to taxation because the income-receiver is living there while some other local income of the same nature, originating within the same boundaries, is not subject to taxation owing to the fact that the income-earner is residing elsewhere.

The local authority may tax residents and, in addition, the non-residents on income originating internally. In this case, inter-personal disparities in taxation appear, within the same local unit, between non-residents. Indeed, non-resident 'A' may have to pay another tax to his locality of residence; while non-resident 'B', whose locality of residence is a non-taxing jurisdiction, will go scot-free.

## 2. Partition of Ability to Pay:

It was already pointed out that the principle of progression can only be sound if applying to total individual (net) income of whatever type and from whichever area.

Consequently, the taxation of personal income, on the local level, can adversely affect sound progressiveness on account

of the dismemberment of income either by type or by region.<sup>(1)</sup>

# 1. Income Partition by Region:

The basis of local income taxation, compatible with the principle of progression, is that of residence, not situs. Residence brings all income, accruing to the same individual, under the fiscal action of ~~the~~ one and the same junior authority.

However, many underlying authorities, especially the debtor ones, may not find the basis of residence suitable to them either for technical or for economic and financial considerations. In fact, localizing income is not always easy as in the case of dividends and certain wages and salaries paid to "commuters" (e.g. transport undertakings). Clearly, the debtor areas stand to lose by adopting residence. Furthermore, if there are large inter-area tax differentials, or taxing localities co-existing with non-taxing localities, the local wealthy residents may tend to out-migrate to lowly taxed or to tax-free, areas.

Therefore, the basis of situs will be preferred by certain minor taxing jurisdictions. However, situs involves the geographical dismemberment of personal income and consequently militates against, or defeats, the application of a graduated scale on the local level.

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(1) The writer does not favour the application of progression on the local level and prefers proportionality. However, in some cases, mild progression could be adopted, e.g. more or less agricultural countries (with little inter-jurisdictional income) and wide areas, provided the basis of residence is resorted to.  
See, "Intergovernmental Fiscal Co-ordination."



## 2. Income Partition by Type:

The local taxation of certain flows of income, to the exclusion of others, or the imposition of schedular taxes independent from one another, are two cases conducive to the divisibility of ability to pay. This may be exemplified by the introduction, on the local level, of an exclusive or partial tax on wages and salaries, either originating within the locality wherever is the recipient or accruing to the local residents from whatever source.

The partition of income by type hampers the principle of progression, adopted by some territories, progression being inapplicable to separate partial flows of income. The beneficial distinction between earned and unearned income may be also obscured. Furthermore, the type-dismemberment of income is conducive to multiplicity of allowances either to residents or non-residents.

Concerning the duplication of allowances to residents, it is to be noticed that allowances can only be soundly granted on the basis of total individual income and not on slices of income.

As for the case of non-residents, it is a moot question whether they should enjoy allowances. If the non-residents are accorded the same allowances as residents, the former may enjoy more allowances than residents deriving all their income within the local boundaries. On the other hand, if the non-

residents are not granted allowances they may be discriminated against.

Various solutions may be applied. Partial allowances could be granted to non-residents. Some states in the U.S.A. vary the allowances according to the proportion of the non-resident taxpayer's gross income earned in the state. Net income could, however, be taken instead of gross income. Moreover, non-residents could be granted allowances in proportion to the number of years passed within the local area.

taxation, is discussed more fully in the next chapter.<sup>(1)</sup>

We may thus concentrate here on the second factor.

The inter-local tax differentials may be due to differences in the definition of taxable income, differences in the provision of allowances and disparities in the tax structure or tax rates of the diverse junior taxing jurisdictions. Clearly, the co-existence of taxing and non-taxing localities is to be added.

The outcome of fiscal discrepancies between the various areas is that the income-receivers, residing in these areas find themselves treated in dissimilar ways. This involves a violation of the central tenet of fiscal equity which consists in the equal treatment of persons dissimilar in no relevant respect.

(1) See "Overlapping and Multiplicity", Section III, "Local Personal Income Taxation."

## II. Inter-Local Fiscal Inequity.

Inter-local fiscal inequities and inequalities may be due to two main factors; the problem of interjurisdictional income and the tax differentials due to the inter-local disparities in the fiscal burden.

The former factor has been already referred to in connection with intra-local fiscal inequity. The analysis can be construed in its inter-local aspect. Moreover, the unfair tax treatment, due to overlapping and multiple taxation, is discussed more fully in the next chapter.<sup>(1)</sup>

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(1) See "Overlapping and Multiplicity", Section III, "Local Personal Income Taxation."

It is noteworthy that the inter-area fiscal inequalities, due to the causes outlined above, assume more substantial proportions in a federal polity than in a unitary country.

The U.S.A. may be referred to for illustration.

# 1. Disparities in The Concept of Taxable Income:

The personal ability to pay may not be conceived identically in all the localities of a given country. Some disparities are conducive to inter-personal and inter-area fiscal inequalities. We may analyse some significant items of income.

Dividends may not be treated in all subordinate units in the same way. They may be subject to taxation at ordinary rates or at additional rates or be dropped altogether. The varying local practices with respect to dividends especially lead to inequalities if the dividends constitute a large proportion of taxable income and if the regional income tax is graduated. In the later case, it is clear that the inclusion or exclusion of share profits affects the position of the taxpayer in the scale of regional graduation.

Residence in connection with dividends and interest is also a source of trouble. Non-residents receiving such sums from a local business may be dissimilarly treated by the various localities in the country; some may tax them and some may not.

It is helpful to refer to the U.S.A. for concrete



illustrations of inter-area disparities.

The American states pursue different policies in the taxation of dividends. Some keep them aside by exclusion, deduction or the credit system. Some subject them to ordinary taxation and some to a surtax. Eight states exclude the dividends to the extent that they are paid out of corporate income which they already tax. Iowa, South Dakota and Missouri allow a credit equal to the corporation tax on dividends. In seventeen states, dividends are subject to the full local income tax. Oregon and Colorado impose surtax besides the ordinary tax.

Non-residents getting dividends or interest from local corporations are sometimes taxed and sometimes not.<sup>(1)</sup>

The problem of inter-area differences in dividend taxation is especially important in the U.S.A. as the state income taxes are often progressive and dividends form 5.23 per cent of incomes below \$ 5000 (reported to the Federal Government on 1937 income), 12.95 per cent of incomes between \$ 5000 and \$ 10,000 and 68.36 per cent of incomes from \$ 500,000 to \$ 1,000,000.<sup>(2)</sup>

As for securities, there is also much scope for heterogeneity in their local fiscal treatment. It is noticeable

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(1) Blakey and Johnson : op. cit. p.8

(2) Bureau of Internal Revenue, Statistics of Income. 1937. Part I.

that there are four orders of securities liable to variations, the "central securities" issued by the national government, the "local securities" issued by the local governments, the "sub-local securities" issued by the hierarchical subdivisions of the same locality or those of the other localities in the same country, and the "co-local securities" issued by the other local units within the same country.

The interest on all these securities may be exempt or taxed with subsequent effects on personal fiscal burden and inter-local tax differentials.

Reference to the U.S.A. again can be fruitful. If all states, at the present time, exempt interest on obligations of the Federal Government and of other co-states and their hierarchical subdivisions, heterogeneity prevails in the case of interest on home (state) securities. There are also variations in connection with local securities. Some states tax their own securities; whilst others do not. The interest on securities of the political subdivisions of the taxing state are also either included in personal income or not taxed at all.

## 2. Disparities in Personal and Family Allowances:

Inter-area and inter-personal fiscal inequity can stem from disparities between the lower taxing units in the provision for personal and family charges. The differentials in tax liability depend on the amount of such allowances (or

absence of any allowance), and the relative changes in the position occupied by the local taxpayers in the regional scales of graduation.

The methods of allowing for personal charges may not be uniform all over the localities. Some units may adopt the form of deductions, some others may resort to a system of "tax credits" against tax of a certain amount.<sup>(1)</sup> The income tax liability varies in these two cases if the regional income tax is progressive. The application of the tax credit system results in a somewhat larger liability for a net income of a given size than in the ordinary way of granting the allowances. In the former case the tax rates are applied before the tax credits are granted, while in the latter case the rates are applied after stated allowances have been deducted from net income.

It is worthy of note that the problem of residence and non-residence is a source of confusion and disagreement between local bodies.

All states in U.S.A. grant exemptions (or allowances) except Tennessee. There are variations in the extent and devices of these allowances with subsequent inter-personal and inter-state inequalities.

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(1) These tax credits are not to be confused with the tax credits connected with central-local and inter-local fiscal relations, referred to in due course.

Until before World War II, most of the states provided for exemptions either equal to or lower than the federal level of \$ 1000 for a single and \$ 2,500 for married persons.

After the War, there prevailed relatively more differences. The exemptions now range from \$ 200 in New Hampshire to \$ 850 in Oklahoma. Some states grant \$ 1,500.<sup>(1)</sup>

The allowances affect two main forms; deductions or tax credits. The latter method is used in five states: Arizona, Iowa, Minnesota, South Dakota and Wisconsin.

Some states distinguish between residents and non-residents. Georgia grants an exemption of \$ 1000 for single residents and \$ 2,500 for married residents plus \$ 400 for each dependent. However the non-resident in that state, gets only \$ 1000 whether he is married or not, with children or not.<sup>(2)</sup>

### 3. Disparities in The Local Tax Structure:

Various aspects of inter-area dissimilarities can be noticed in this field. The subsequent inequalities clearly stem from the fact that similarly situated persons are dissimilarly treated just because they happen to reside in one regional area rather than another.

The tax rates and the steepness of the graduation may be

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(1) Federal, State and Local Government Fiscal Relations. 78th Congress, 1st Session. Senate Document No.69. Washington, 1943. p.423.

(2) Blakey and Johnson : op.cit. p.78.



different from locality to locality. The form of the graduation may not be the same as there are so many devices of progression notably graduation by total income and graduation by brackets. A distinction may or may not be drawn between earned and unearned income in the computation of the local tax.

If we turn to the U.S.A. for illuminating examples, we encounter inter-state differences in tax structures involving fiscal inequalities between persons residing in different states.

The tax rates range from 1 per cent to 6 or 7 per cent. In a few cases they are even higher reaching 15 per cent on taxable incomes of \$ 15,000 in North Dakota and incomes of \$ 250,000 in California.

The progression is fairly steep. In about half the states it terminates however at \$ 10,000 although in other cases it may continue further.

Unearned income is either subject to high rates or receive favourable treatment. Massachusetts, Maryland, Vermont tax intangibles at a higher rate. Many states reserve favourable treatment to dividends, interest on government securities and capital gains. Conversely, some states discriminate against unearned income such as Colorado and Oregon by levying a surtax on income from intangibles.

The Principle of Equalization Applied to the Allocation of Grants-in-Aid.  
Federal Security Agency - Social Security Administration.  
Bureau Memorandum, No. 50. Washington, 1941. p. 25.

### III. Central-Local Fiscal Inequity.

The combined burden of central-local taxes may militate against the sound progression of the total fiscal burden and may also result in a repressive and unfair final load.

These breaches to fiscal equity and the subsequent propensity to avoid the taxes can be coped with thanks to two devices, namely; tax crediting and deductibility.<sup>(1)</sup> Their implications may be reviewed.

#### 1. Tax Crediting.

This process consists in reducing the tax due to the central government by an amount equal to all or part of the tax payable to the underlying tiers of government.<sup>(2)</sup>

The tax credits can thus be comprehensive or partial.

Although tax crediting is akin to tax sharing in its objectives, yet it is different in concept as each taxing authority retains its jurisdiction to tax independently.

(1) See also Part Three, Intergovernmental Fiscal Co-ordination.

(2) "The tax-credit device allows a taxpayer to meet part of his tax liability to the National Government by receipts for a similar tax paid a constituent State. It is simply a tax 'umbrella' put up by the central government, which 'encourages' every State to adopt that specific tax." :

Johnson, Byron L.

The Principle of Equalization Applied to the Allocation of Grants-In-Aid.

Federal Security Agency - Social Security Administration.  
Bureau Memorandum, No.66. Washington, 1947. p.25.

# 1. Effects on Fiscal Equity:

The provision of tax credits, in central-local fiscal relations, results in mitigating the combined burden of central plus local taxation which may be heavy or crushing particularly within a federal polity in the new post-war conditions.

If the tax credit is comprehensive of the whole local levy, it clearly sets the central tax as a maximum.<sup>(1)</sup>

From the viewpoint of progressive taxation, central-local tax-crediting has an advantage over local autonomous taxation and over the local supplementation of central taxes in that it (i.e. tax crediting) does not damage the graduation of the national tax system as a whole, that is, central plus local. Over-all progression is safeguarded if already existing.

The same result occurs if the crediting is partial and affects the form of high percentages of the local taxes for the low-income groups and low percentages of the local taxes for the high-income groups. However, if the scale of percentages is reversed, or if the credits affect the form of a fixed amount, total progressiveness may be affected especially if central graduation is mild.

As for the local tax systems, they may still (after crediting) exhibit, in their relations inter se and apart from

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(1) Groves, Harold : The Scope of State Income Taxation Under Present Conditions. National Tax Association, Proceedings, 1935.

central taxation, some tax differentials if they impose varying burdens of taxation or if the credits are partial and provide for low percentage reductions on the low income brackets and high percentage reductions on the high income brackets since the low-income receivers prevail in the under-endowed areas and the high-income receivers in the wealthy areas. high income brackets. This device serves the interests

From the point of view of inter-local fiscal inequalities, tax crediting may exert a remedial effect in so far as it induces the non-taxing units to resort to income taxation. However, it must not be overlooked that the more the junior taxing jurisdictions the more the overlapping and confusion.

If the tax credits are partial and bear high percentages for the low-income earners and low percentages for the high-income earners, as will be soon recommended, a beneficial inter-area redistribution of the tax burden will ensue since the under-endowed areas have a relatively smaller number of wealthy residents. percentages will not be too

## 2. Effects on Revenue:

The recourse to tax credits comprehensive of the whole local tax may cause prejudice to the central treasury as this is tantamount to relinquishing part of the proceeds to the junior authorities. The detrimental financial impact from the central standpoint is the greater the heavier the local levies and/or the lighter the central taxes. However, in so far as



the taxpayers are protected from fiscal overburden or near-confiscation, resulting from central plus local taxation, the ultimate financial benefits may prove worthwhile.

The writer advocates, as an alternative to comprehensive tax crediting, the resort to partial credits bearing high percentages on the lower income brackets and low percentages on the high income brackets. This device serves the interests of the national treasury and falls in line with the current centripetal tendencies referred to above. In fact, a kind of separation of tax sources "by brackets" takes place whereby the high income brackets, potentially more productive, are reserved for the central government.

From the local point of view, the proposed modified tax credit system militates in favour of the under-privileged areas which contain proportionately more low-income earners than the well-off areas.

It is noteworthy that the granting of tax credits in form of flat percentages will not be very advantageous to the subordinate government units if their income taxes carry very low scales of graduation while the central income tax carries sharply graduated rates on the higher brackets. Consequently, the junior taxing authorities might be induced in this case to adopt steeply progressive taxes, a tendency to be strongly deprecated by reason of its detrimental character to the rational progressiveness of the national tax system as a whole.

### Overview:

In the writer's opinion, it is necessary, when applying tax crediting in central-local relations (or in inter-local relations<sup>(1)</sup>) to make use of an all-localities uniform device. The opposite practice may usher in inter-local fiscal inequalities.

In connection with the latter point, central-local tax crediting could be utilized by the central authorities as a bargaining power to foster inter-area uniformity in tax provisions so beneficial from the fiscal equity standpoint. The device could be introduced on this condition.

### 2. Tax Deductibility.

The joint central-local fiscal load can be mitigated by means of another device, namely tax deductibility. This consists in subtracting, from the tax base, the tax imposed by the other authority. By alleviating the total burden of two similar levies, deductibility avoids confiscation which cannot occur so long as no one tax alone is confiscatory (i.e. exceeds 100 per cent), whether the rates are effective rates or apply only to higher brackets.

Deductibility is thus a mild form of tax crediting.

Deductibility may be unilateral or reciprocal. In the former case it can be conceded by the central jurisdiction

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(1) See Chapter II, Section III.

alone or by the local unit alone.

It is also to be mentioned that deductibility may be partial (limited) or total; one tax being partially or totally deducted from the base of the other tax.

The most usual applicable forms are either mutual deductibility or the deductibility of the local tax by the central authorities.

#### 1. Deductibility and Taxpayers' Differentials:

The device under discussion does not only contribute to mitigation of repressive central-local tax load but it also reduces the inter-area tax differentials generally and notably the differentials between taxing and non taxing localities.

It is worthy of note that mutual deductibility leads to a situation very near the case where the subordinate units of government have no tax.

Reciprocal deductibility, however, reduces the effective local rate on the higher income groups more than on the lower ones. The device is in fact most effective throughout the scale when one tax burden is heavy and the other is light.

It may be stated that when the central tax rates are high, in the case of reciprocal deductibility, the combined central-local effective tax rate will not very much exceed the position where central taxation does not give heed to local taxes.

If the size of the differential is expressed in the form

of an effective percentage rate on income, it is found that, under reciprocal deductibility, it is smaller than under unilateral deductibility. The differentials also vary in inverse proportion with the central tax rates. When the latter increase, the size of the differential becomes smaller especially from the point where the local tax progression ceases.

Clearly, the effective rate of the differentials decreases in absolute magnitude if the rate of decline of the differential is greater than the rate of increase of (net) income.

## 2. Deductibility and Progression:

Unlike tax crediting, the system of deductibility affects the scale of graduation of the local taxes, the central taxes and the national tax system as a whole, that is, central plus local. Indeed the tax basis itself is reduced by varying amounts. The effects depend on the form and extent of the deductions.

In the case of unilateral deductibility, by the junior authorities, of the central (progressive) tax, the progression of the local tax, when graduation is locally applied, will be adversely affected and may turn regressive.

In unilateral deductibility, by the central taxing jurisdiction, of the taxes imposed by the underlying taxing jurisdictions, some milder form of central tax progressiveness



may ensue especially when central graduation is not strong.

Reciprocal deductibility, mitigates the scale of graduation of the national tax system as a whole, that is, central plus local.

### 3. Computation:

In the opinion of the writer, the deductions must be based on the same year's income and not on that of the previous year (as in the U.S.A.) The latter case may lead, under certain assumptions, to considerable personal fiscal inequity and to accentuation of inter-personal fiscal inequity i.e. inequity between two individuals in identical financial positions residing in the same locality.

Suppose A and B have the same taxable income in a given year. A's income was subject to a great change relatively to the previous year while that of B remained the same or did not change much. A's income in the previous year may have been so small as to be exempt or A may have been residing in a non-taxing locality and then moved to a taxing locality or he may have incurred a loss. On the following year, A will not enjoy any deduction, while B, who earns on that year the same income, gets the benefit of deductibility.

The outcome may be, not only more inter-personal fiscal inequity, but possibly a confiscatory burden on A who will bear both local and central income taxes added together. In post-war conditions of heavy central taxation, required by economic

control or cold-war, the burden on A is likely to be confiscatory.

#### 4. Economic Effects:

The adoption of the device of deductibility constitutes an inducement to non-income taxing localities to tax income. This will have a favourable impact on the inter-local distribution of resources as the bidding for taxable resources will then affect the form, not of taxation versus exemption, but of deductibility versus non-deductibility. The former situation is a stronger contributory factor in inter-area discrepancies in per capita wealth and income and hence in fiscal burden.

Furthermore, the procedure of deductibility, by curbing tax avoidance, reduces the baneful efflux of taxable resources.

#### 5. Effects on Revenue:

Local revenue, of an income-taxing locality, will be adversely affected through the application of reciprocal deductibility and deductibility of the central tax.

As for central revenue, it is liable to be affected under reciprocal deductibility and that of the deductibility of the local tax.

Moreover, as the central government will collect less revenue on the same income in an income taxing locality than in a non-income taxing locality, the generalisation of deductibility, by inducing the non-taxing localities to resort

to income taxes, causes prejudice to the central treasury.

On the other hand, as reciprocal deductibility reduces the effective local rate on the higher income brackets more than on the lower brackets, this is tantamount to some type of beneficial separation of revenue sources "by brackets" whereby the central government is left, for the purposes of revenue exploitation, with the higher income groups potentially more productive and the subordinate authorities are left with the lower groups.

#### 6. Limitations to Deductibility:

Despite its merits, the device under discussion is not as far-reaching as tax crediting. Furthermore, deductibility exerts no remedial effects on the diversity of the local taxes unless it is deliberately wielded as a tool for this end.

It may even be mentioned that deductibility has the disadvantage of promoting income taxation on the local level and hence gives rise to fiscal inequities and conflicts.

There is little doubt, however, that the device of deductibility, as used in central-local relations, is a shield against confiscatory taxation through joint central-local fiscal pressure which may occur under contemporary economic conditions.

The writer advocates the resort to either reciprocal deductibility or the unilateral deduction, by the central authorities, of the taxes on the local level.

Moreover, these devices could be used as instruments to achieve or foster central-local uniformity in taxation. They can be made conditional on fulfillment of certain desiderata.

#### 7. Deductibility and Experience:

The method is applicable and applied when there are multiplex and conflicting taxing jurisdictions, notably within a federal structure.

In the U.S.A. 33 states impose corporate net income taxes; 22 states grant unlimited federal tax deductibility, 2 limit the deduction and 9 deny it completely.<sup>(1)</sup>

While New York and California do not allow deductibility, Wisconsin limits it to 10% of net corporate income and Massachusetts does not extend it to intangibles.

It is noticeable that Oregon and Vermont allow deduction to individuals but not corporations and that Wisconsin confines it to 3 per cent of non-corporate net income.

In Canada, the Dominion income tax did not allow deductibility of provincial taxes.

As for the provinces, only three allowed the deduction of the Dominion income tax. The inter-provincial tax differentials were therefore glaring.<sup>(2)</sup>

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(1) "Federal, State and Local Government Fiscal Relations".  
op.cit. p.438.

(2) See the table below.



It must be added that the high tax rates of the Dominion income tax after World War II would have confiscated nearly or completely the income above certain brackets if the Dominion-provincial agreements had not been reached.

In Australia, the Commonwealth government allowed, before the War, the deduction of state tax. As for the states, New South Wales and Victoria did not allow it.<sup>(1)</sup>

There were substantial tax differentials between residents in the various federating states.

(2) During the war, as already pointed out, the state taxes were transferred to the Commonwealth level, against compensation. *versus.*

(3) Federal tax deductible in calculating state tax but not vice versa.	80.0	3.0	83.0	40.0	3.0	43.0
(4) Each tax deductible in calculating the other.	77.27	3.41	80.68	37.50	3.35	40.85
(5) States have no tax.	80.0	-	80.0	40.0	-	40.0
(6) State tax credited on Federal tax.	65.0	15.0	80.0	32.0	18.0	50.0

(1) Barkmeier, Joseph H. : "Income and Excess Profits Taxes in Australia." N.S. Dept of Commerce, International Reference Service. vol.1, No.41. July, 1941. p.5.

U. S. A.

1. Percentages of Taxable Income Taken by Hypothetical  
Federal and State Income Taxes Under Various Assumptions.

Assumption	Percentages of Taxable Income Taken by					
	Federal Tax 80%	State Tax 15%	Combi- nation	Federal Tax 40%	State Tax 10%	Combi- nation
(1) <u>Neither tax deductible in calculating the other.</u>	80.0	15.0	95.0	40.0	10.0	50.0
(2) <u>State tax deductible in calculating Federal tax but not vice versa.</u>	68.0	15.0	83.0	36.0	10.0	46.0
(3) <u>Federal tax deductible in calculating state tax but not vice versa.</u>	80.0	3.0	83.0	40.0	6.0	46.0
(4) <u>Each tax deductible in calculating the other.</u>	77.27	3.41	80.68	37.50	6.25	43.75
(5) <u>States have no tax.</u>	80.0	-	80.0	40.0	-	40.0
(6) <u>State tax credited on Federal tax.</u>	65.0	15.0	80.0	30.0	10.0	40.0

(1) Allen and Brownlee : op. cit. p.486



U.S.A.

States With Highest And Lowest

Taxes A Head. (1)



(1) Compendium of State Government Finances in 1952,  
U.S. Department of Commerce. Bureau of the Census  
Quoted by The Economist. London. 4 Nov. 20, 1953



U. S. A.

2. Federal and State Income Tax Liability as a Percent  
of Net Income at 1941 rates. (1)

Under Different Assumptions of Deductibility

Net Income \$	California Per Cent	New York Per Cent
(1) <u>No Deductibility.</u>		
3,000	4.8	4.9
5,000	8.0	8.8
20,000	25.1	28.0
100,000	60.4	59.3
1,000,000	87.3	80.2
5,000,000	93.3	85.5
(2) <u>Unilateral (Federal)</u> <u>Deductibility.</u>		
3,000	4.8	4.9
5,000	7.9	8.6
20,000	24.2	26.0
100,000	55.2	54.8
1,000,000	76.3	74.8
5,000,000	81.3	79.8
(3) <u>Reciprocal Deductibility.</u>		
3,000	4.7	4.8
5,000	7.8	8.4
20,000	23.7	25.0
100,000	53.2	53.7
1,000,000	74.0	73.7
5,000,000	79.1	78.8

Note: The taxpayer is a married man and has no dependents.

(1) "Federal, State and Local Government Fiscal Relations".  
 op.cit. p.439.



CANADAProvincial Income Tax - Proportion of Gross IncomeMarried man with no dependents - Prior to September 1939Dominion income tax increase.Local Business Taxation

Income	British Columbia	Alberta	Ontario
\$			
100,000	23%	26%	7.4%
500,000	27%	29%	7.8%
1,000,000	27%	30%	7.7%

The gross inter-provincial tax differentials are due to the fact that in British Columbia and Alberta the income tax paid to the Dominion Government was not allowed as an exemption while it was deductible in the case of Ontario.<sup>(1)</sup>

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(1) Report of the Royal Commission on Dominion-Provincial Relations.

Book II, Recommendations. Ottawa, 1940. p.158.

### SECTION III

#### Local Business Taxation

##### INTRODUCTION.

Before the implications of the problem are discussed with reference to unitary and federal countries, two points are worthy of note regarding the nature and scope of business fiscal inequity and inequalities in both polities.

The lower layers of government, in unitary countries, do not generally resort to the taxation of business as collective organic units, on net income or gross receipts. The local taxes are often levied on some other indexes which are no expression of taxpaying capacity such as premises occupied, fixed capital or nominal capital stock. The burden falling on local business may be so manifestly unfair that it could scarcely be justified by any theory of taxation other than the Social-Expediency Theory. The local taxation of business in unitary countries thus involves a "basic fiscal inequity".

Within a federal polity, the minor governments enjoy wider financial powers. They levy taxes both unrelated to impersonal ability to pay and related to it (i.e. on corporate net income). In the former case, the minor governments are responsible for "basic fiscal inequity". In the latter case,

they generate an "induced fiscal inequity". In fact, owing to the problem of inter-local business income, the local taxation of corporate income is beset with considerable technical and practical difficulties which ultimately lead to some type or another of inequity (overlapping, multiplicity, evasion...)

If a local unit taxes the whole income of the local business, irrespective of its jurisdictional source, multiple taxation is liable to arise since the other local units might tax the corporate income originating within their respective boundaries.

If the local taxing jurisdictions resort to different devices for the purpose of apportioning cosmopolitan business income, duplicate taxation arises on account of the dissimilarity of methods applied. The same result is brought about by the varying significance attached to the components of the same criterium.<sup>(1)</sup>

Furthermore, the regional corporate income taxes may exhibit diversities as regards the structure of the rates, their level and central-local deductibility.

The lower strata in federalism, having a more free-hand, are also bent on levying a diversity of complex and arbitrary

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(1) Haig, Robert Murray : "The Cost to Business Concerns"

(1) Overlapping and multiplicity are tackled with more detail in Chapter II. We are here concerned with their intra-local implications, not with their inter-local aspect.

imposts which, through pyramiding, result in a repressive tax burden on local business activities.

The unfair burden in local business taxation can also stem from forward shifting to the consumers. The regressivity is thus present in the effective incidence as well as in the formal incidence.

Besides regressiveness and repressiveness, the costs of tax compliance involved in stratiform business taxes may be very high. In the U.S.A. they may reach 10.5 per cent.<sup>(1)</sup>

basis of their annual rental value. The amount of profit has little or no connection with the buildings occupied. A lucrative business may occupy little or no space and vice versa. The true gauge of the remunerative nature of the enterprise is the net profit actually realised. If the turnover or total sales or capital stock have little link with business profit, the space occupied has none.

The regressive character of the rates on business has been further accentuated by the levying process which relieved mines, factories and railways of 75 per cent of their burden and completely exempted agricultural hereditaments in 1929. The occupiers of small shops and offices came to bear a

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(1) Haig, Robert Murray : "The Cost to Business Concerns of Compliance with Tax Laws," in: The Management Review. November, 1935. p.328.

Industry and railways was paying 4 per cent.<sup>(2)</sup>

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(2) Local Government News Service. July, 1939.

① It is to be noted that revolution without re-rating will further increase the unfair treatment of shops & commercial properties as their rateable



## I. Unitary Countries.

Apart from a profusion of fess and tolls there are some local taxes which deal more specifically with business. It is interesting to examine one example; namely the British system.

The British local rates on industrial and business hereditaments are unfair in their formal and effective incidence alike. The rates are assessed on premises on the basis of their annual rental value. The amount of profits has little or no connection with the buildings occupied. A lucrative business may occupy little or no space and vice versa. The true gauge of the remunerative nature of the enterprise is the net profit actually realised. If the turnover or total sales or capital stock have little link with business profit, the space occupied has none.

The regressive character of the rates on business has been further accentuated by the derating process which relieved mines, factories and railways of 75 per cent of their burden and completely exempted agricultural hereditaments in 1929. The occupiers of small shops and offices came to bear a relatively heavier burden than the rest of economic activities e.g. agriculture and industry. <sup>(1)</sup>

In 1939 they were paying 5 per cent while the rest of industry and railways was paying 4 per cent. <sup>(2)</sup>

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(2) Local Government News Service. July, 1939.

(1) It is to be noticed that revaluation without re-rating will further increase the unfair treatment of shops & commercial properties as their rateable value will be very much increased.

The core of the inequity is that the subsequent increases in the rates, responding to expanding local expenditures, were bound to generate more regressiveness. Grants were paid by the Exchequer but they were inelastic being fixed at £22 million.

The following table shows that the rates formed nearly the same percentage of an increasing local revenue (i.e. from rates plus grants) in 1939. In fact, after derating the share of rates in local income gradually increased and the share of grants gradually decreased as is suggested by the table. Between 1929-30 and 1938-39 there was an increase of 16.7% per cent in the average amount collected per head which passed from £3. 18s. 11d. to £4. 12s. 2d. The average rate in the pound (in England and Wales) increased from 11/6<sup>3</sup>/<sub>4</sub>d to 12/2d over the same period.<sup>(1)</sup>

Year	Rates Percentage of Total Income	Grants Percentage of Total Income
1929-30	37%	25%
1930-31	33%	29%
1938-39	35%	26%

It is noticeable that the judicial interpretation of the

(1) Silver, A.N. : The Reform of Local Government Finance.  
London, 1945. p.10-11.

Derating Act caused further inequalities. The Act derated all productive industries. However, it is difficult to establish clear demarcation lines between productive and non-productive processes. Consequently, anomalies made their appearance. Rag-picking was derated, while cold storage was not! (1)

Prof. Cole, referring to the Derating Act, says; "De-rating, in spite of the compensating grants paid out of the Exchequer, has acted to the detriment of small householders and of shopkeepers, and has reduced the rating system to the last absurdity of unfair incidence." (2)

The regressiveness of the local rates on business is also remarkable in their effective incidence. Although in the short run they are generally borne by business yet in the long run, the rates, or the increase in them, tend to be incorporated in the selling price of the product as is the case with outlay taxes. Thus ultimately the rates fall on the consumers. (3)

Sometimes, backward shifting occurs instead of forward shifting, and the final consumers thus escape the incidence. This occurs, for instance, in the case of leaseholders who are protected from increasing rentals caused by increases in the

(1) Silver, A.N. : op.cit. p.10 (footnote).

(2) Cole, G.D.H. : Local and Regional Government. London, 1947. p.223.

(3) Hicks, U.K. : Public Finance. Cambridge, 1947. p.198.

rates and more generally whenever the occupiers can pass the increase to the owners of the premises.<sup>(1)</sup>

Moreover, the consumers residing in areas where prices have increased through forward shifting, may avert the additional burden by buying in other areas (e.g. postal shopping) where rates have not increased or where chain stores or more efficient businesses are able to absorb the higher rates or to offset the high rates in an area by the lower rates of another where they also operate.<sup>(2)</sup> The same results to the consumers may obtain through substitution.

We now discuss corporate income taxation and non-corporate income taxation.

#### Corporate Income Taxation:

The secondary governments, within a federation, may subject corporate income to taxation. This criterion of business taxpaying capacity is equitable.

However, the resort, on the regional or local levels, to corporate income taxation is fraught with violations of fiscal equity for various reasons. We may turn to the U.S.A. for illustration.

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(1) Sykes, Joseph : A study in English Local Authority Finance. London, 1939. p.82.

(2) Sykes: op.cit. p.83.



## II. Federal Countries.

The business fiscal inequities and inequalities assume greater importance within a federal polity in view of the stratiform structure of taxing authorities and the diversity exhibited between areas. Business taxation, may be resorted to, not only by the regional governments, such as the states and provinces, but also by tertiary authorities. The latter may even adopt taxes on net corporate income as the District of Columbia, in the U.S.A. or they may consider net income as a measure such as Ohio, Toledo, Springfield and Dayton. We may now discuss corporate income taxation and non-corporate income taxation.

### 1. Corporate Income Taxation:

The secondary governments, within a federation, may subject corporate income to taxation. This criterion of business taxpaying capacity is equitable.

However, the resort, on the regional or local levels, to corporate income taxation is fraught with violations of fiscal equity for various reasons. We may turn to the U.S.A. for illustration.

#### 1. Inter-Area Diversity:

The lower-tier taxes on business income will not be necessarily homogeneous. The various areas are likely to exhibit disparities in rate structure, the level of the rates and other divergencies, for instance in connection with tax

deductibility. Furthermore, there may co-exist taxing and non-taxing authorities.

In the U.S.A., 32 states tax corporate income on their net income, 26 states have flat rates and 6 states have graduated rates.

The level of the rates also vary. It may be 3% or 8% as in Oregon (now 7%). The highest graduated scale is in Idaho with 1.5% on the first \$ 1,000 to 8% on the excess over \$ 5,000.<sup>(1)</sup>

Furthermore, the practice concerning federal-state deductibility is not uniform. In 1949, 17 states allowed it, others did not. Wisconsin allowed limited deductibility.

The table below gives some idea of inter-area disparities.

### 3. Interjurisdictional Incomes:

The unfair treatment, in this connection, stems from the inherent overlapping causative of multiple taxation on inter-area firms. Separate accounting would cope with the problem.

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- (1) Kimmel, Lewis H. : Taxes and Economic Incentives. Washington, 1950. p.44.

It is noteworthy that progression in business taxation is a moot question even on the central level.

Section IV.

U. S. A.

The Diversity of State Corporate Income Taxes, Examples,

Dec. 1949. (1)

State	Rate or Rates	Status of Federal Income Tax
Alabama	3 per cent.	Deductible
Georgia	7 per cent.	Deductible
Idaho	Graduated: $1\frac{1}{2}$ per cent on first \$ 1,000 to 8 per cent on excess over \$ 5,000.	Deductible
New York	$5 - \frac{1}{2}$ per cent; minimum tax, \$ 25.	Not Deductible
Pennsylvania	4 per cent.	Not Deductible
Wisconsin	Graduated: 2 per cent on first \$ 1,000 to 6 per cent on excess over \$ 6,000 plus surtax of $16\frac{2}{3}$ per cent of computed tax less \$ 75.	Deductible to extent of 10 per cent of net income.

2. Interjurisdictional Incomes:

The unfair treatment, in this connection, stems from the inherent overlapping causative of multiple taxation on inter-area firms. Separate accounting would cope with the problem. However, it is beset with difficulties.<sup>(2)</sup> Other devices may

(1) Kimmel, Lewis H. : op. cit. p.202.

(2) See next chapter on "Overlapping and Multiplicity", Section IV.

be resorted to for the purpose of inter-area income apportionment, such as the ratio of local to total expenses of the business or the application of some allocation formula.

We may now discuss the latter device on the light of fiscal equity.

The construction of the allocation formula, which will have to be based on certain criteria, may not militate in favour of fiscal equity. Two points may be mentioned. First, the criteria on which the formula is based may not represent adequately the portions of income realised within each local area. Second, heterogeneous formulas may be in application by the diverse taxing jurisdictions. The outcome may be a final fiscal load of more than 100% of the total income of the inter-area concern, which will be thus discriminated against. Furthermore, the formulas, even if homogeneous, may be interpreted differently by the minor authorities to their own financial advantage.

The American states, in an attempt to determine the domestic share of pan-state (i.e. interjurisdictional) corporate net income, resort to one or more of the following factors as allocation fractions: <sup>(1)</sup> gross receipts or sales,

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- (1) The allocation fraction is obtained by relating the factor adopted within the state to the total or full expression of the same factor, e.g. the allocation factor of payroll is,

$$\frac{\text{Payroll within the state}}{\text{Total Payroll}}$$

See:

Hansen, Alvin H. and Perloff, Harvey: State and Local Finance in the National Economy. New York, 1944. p.44.



tangible property, payroll, manufacturing costs, purchases of goods and materials etc., the cost value of capital assets, accounts receivable, net sales costs, stock of other corporations.

In order to compute the portion of domestic income, the allocation fraction is multiplied by the total net income of the business.

The formula can however be complicated in many ways. The allocation fraction may be composed of several factors or elements combined together. Some form of weighting may be adopted. The formulae may affect intricate algebraic forms.

Those of New York and North Dakota are of this sort.<sup>(1)</sup>

The further complications introduced do not always make the apportionment of income sounder. The opposite is often the case. Some formulas represent local dominating group interests. Averaging opens the door to more fiscal inequity; each state choosing the most advantageous to itself. Where distributing prevails more weight is given to sales. Where manufacturing predominates there is a propension to give more weight to tangible property and wage factors.<sup>(2)</sup> The diversity of the averaging methods adopted in the different states result

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(1) Blakey, Roy and Johnson, Violet : "State Income Taxes." New York, 1942. p.65-66.

(2) Long Henry F. : Interstate Reciprocity in Connection with Corporate and Personal Income Taxation: Tax Relations Among Government Units. Tax Policy League, New York, 1938. p.77.

in a final unfair burden on inter-local business.

The Diversity in Averaging as a Source of Fiscal Inequity

State	Property	Gross Receipts	Even Weight	Most Favourable
			\$	\$
A	\$ 800	\$ 500	5/12 250	8/12 400
B	300	1,500	3/8 225	1/2 300
C	100	200	3/40 45	1/15 40
D	-	800	2/15 80	4/15 160
	\$ 1,200	\$ 3,000	\$ 600	\$ 900

The table shows that a corporation, with a net income of \$ 600 and whose property and gross receipts are spread over several states, pays tax on more than its actual income when each of the states adopts the most favorable averaging to itself.<sup>(1)</sup>

It may be argued that the three-factor Massachusetts formula is used in an increasing number of states and that this militates in favour of uniformity and fairness.<sup>(2)</sup> Yet the formula cannot spread everywhere and for all businesses because

(1) Maxwell, James : The Fiscal Impact of Federalism in the United States. Cambridge, Massachusetts, 1946. p.276.

(2) The Massachusetts formula is an average of three ratios: the value of tangible property within the state to total tangible property, the value of sales within the state to total sales (or gross receipts), value of payroll within the state to total payroll.

because of the differing local investment conditions. Even if the formula is largely adopted it is subject to different interpretations as regards its constituent elements, for instance sales.

Furthermore, a state may adopt different formulas for different enterprises (commercial, manufacturing...). Even when a formula is adopted, it may be modified whether it is introduced by regulation or by statute. In fact, in the latter case, the administration is generally left with some latitude to review the formula.<sup>(1)</sup>

## 2. Non-Corporate-Income Taxation:

A host of secondary and tertiary taxes on business are not connected with impersonal ability to pay and therefore are less equitable than corporate income taxes.

The tax on gross receipts is connected with the consumers rather than with business since it is based on the amount of sales and adds to the variable costs of production and distribution.<sup>(2)</sup> In fact, the tax accumulates as a wholesale tax and finally burdens the consumers.<sup>(3)</sup>

Capital-stock may be also subject to taxation on the state

(1) Blakey and Johnson : op.cit. p.65.

(2) Taylor, Philip : The Economics of Public Finance.  
New York, 1948. p.528.

(3) Groves, Harold M. : Financing Government.  
New York, 1945. p.255.

level, in the U.S.A. However, nominal capital does not reflect the real capital of the corporation for various reasons. There are the bonds and other debts. Working capital or invested capital are preferable, but their computation encounters many difficulties, for instance the apportionment of the reserves between the different states according to the share of each state in their formation. Besides, the ratio between net corporate income and capital oscillates widely and more than the ratio between net and gross incomes.

The occupation taxes, probably the most regressive of all, are based on such factors as occupation, equipment, the amount or kind of production, the number of employees or payroll, the area covered by the businesses activities, the population residing in the different local areas.<sup>(1)</sup> Alabama had in 1942, 130 occupation taxes. One of the taxes ranges from \$ 5 to \$ 50 according to the size of the municipal population. Mississippi taxes cotton enterprises according to the main processing operation e.g. bales compressed or knitting machines. By 1946 the occupation taxes had invaded all states. They should be seriously reviewed especially that their yield is so small.<sup>(2)</sup>

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- (1) Groves, Harold M. : "Financing Government." p.256.  
 See also:  
Arant, Roscoe : "Business Taxation in the Southern States"  
 in The Tax Magazine, Vol.XVI No.7, July, 1938. p.463.
- (2) In 1946, the receipts were less than .25 of 1% (= 13.4 million dollars).



A diversity of other taxes, on the state and local levels, impose a further burden on business such as the franchise taxes, severance taxes, property taxes, sales taxes. The latter are more fully examined in the next chapter.

The property tax, to the extent that it falls on business, is also a source of unfair burden whether in its tangible or in intangible forms. The assessment of inventories (manufacturers, merchants) is an important factor. Choosing an "assessment day", as is generally the case in the U.S.A., is a far cry from tax justice. Apart from the fact that property can be concealed on that day, this method discriminates against businesses with a slow turnover but high inventories. The method applied by some states, of taking the average value of inventories suffers the same defect. The valuation of total yearly inventory does not account for such vital factors as the rate of profits and its variations.<sup>(1)</sup>

The irrational property tax on intangibles clearly results in multiple taxation. Stocks and bonds represent real property already taxed.<sup>(2)</sup> Moreover, it implies discrimination against corporate business or limited companies.

In conclusion, it may be appropriate here to quote

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(1) Buchler, Alfred : "Public Finance." New York, 1948. p.342.

(2) Taylor, Philip : op. cit. p.359.

Professor Hansen and Professor Perloff, commenting on the regressive and repressive impact of the secondary and tertiary American taxes on business.

"Business taxes in the states are a conglomeration of heterogeneous taxes imposed for different purposes, on different bases, under many forms of rate schedules and with many types of administrative machinery. They are characterised, in general, by arbitrariness, complexity and lack of co-ordination."<sup>(1)</sup>

Types of Tax	Tax Revenue dollars	Number Taxing States
1. Taxes on Specific Businesses.		
a. Insurance Companies.	113.0	49
b. Public utilities.	99.4	23
c. Corporation franchise and privileges.	87.8	47
d. Privilege & Selling alcoholic beverages.	55.6	46
e. Motor vehicle, commercial transportation.	49.5	47
f. Occupations.	10.1	34
g. Chain stores.	8.9	21
h. Miscellaneous.	71.2	43
Sub-total of taxes on specific businesses.	490.5	
2. Severance Taxes	62.4	23
3. Total Business Taxes	552.9	
4. Total State Taxes	4,974.8	
Ratio of Business Taxes to	16.6%	

(1) Hansen and Perloff : op.cit. p.44.

(1) Allan, Edward and Brownlee, G.H. : "Economics of Public Finance". New York, 1947. p.303.  
In 1945, the state corporate income taxes yielded 595 millions, in 1947 they yielded 451 m. The local governments share a certain portion.  
See Kimmel, Lewis H. : op.cit. p.45.

UNITED STATES

State Business Taxes, 1942. (1)

Types of Tax	Tax Revenue (millions of dollars)	Number of Taxing States
1. <u>General Corporation Net Income Tax.</u>	274.0	32
2. <u>Taxes on Specific Businesses.</u>		
a. Insurance Companies.	113.0	48
b. Public utilities.	99.4	33
c. Corporation franchise and privilege.	87.8	47
d. Privilege & Selling alcoholic beverages.	55.6	46
e. Motor vehicle, commercial transportation.	49.5	47
f. Occupations.	10.1	44
g. Chain stores.	3.9	21
h. Miscellaneous.	<u>71.2</u>	48
Sub-total of taxes on specific businesses.	490.5	
3. <u>Severance Taxes</u>	62.4	23
4. <u>Total Business Taxes</u>	826.9	
5. <u>Total State Taxes</u>	4,974.8	
6. <u>Ratio of Business Taxes to All State Taxes</u>	16.6%	

- (1) Allen, Edward and Brownlee, O.H. : "Economics of Public Finance". New York, 1947. p.303.  
 In 1948, the state corporate income taxes yielded 585 millions, in 1947 they yielded 451 m. The local governments share a certain portion.  
 See Kimmel, Lewis H. : op. cit. p.43.

### 5. Other Federations: Canada and Argentine.

#### Canada:

The incompatibility between local taxation of business and fiscal equity is also noticeable in Canada. The Royal Commission on Dominion-Provincial Relations, in a report in 1941 says; "The present complexity is beyond belief. The most important item is the corporation income tax, levied by the Dominion and most of the Provincial Governments. There are, in addition, taxes levied by one or more governments, on various bases such as capital stock, number of business places, gross revenue, physical volume of output, period of operation, mileage of tract or wire, mileage operated, note circulation, insurance premiums, investments, volume of deposits. They have grown up in a completely unplanned and unco-ordinated way, and violate every canon of sound taxation. As a result investments in the same forms of business are taxed at different rates in the same Province; investments in the same kind of business are taxed at different rates in different Provinces; investments in business operating on a national scale are double or triple-taxed with no relation to earning power; certain forms of business can be and are singled out for discriminatory taxation."<sup>(1)</sup>

Although, by 1951, the war centripetal forces had

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(1) Report Book II, p.113.



confined the personal income tax to the Dominion level alone, the corporation and business taxes continued to be imposed on the local level by provinces (notably Ontario and Quebec) and municipalities. Besides the tax on profits, there are taxes on paid-up capital, business premises, insurance premiums, railway mileage and so on. The municipalities resort chiefly to imposts on gross receipts or on business premises based on capital value, rental value or floor space.<sup>(1)</sup> They also make use of taxes on stock-in-trade (Maritime Provinces, Manitoba, Alberta) which are especially unfair and business licences which are unfortunately increasingly used, not as a means of regulation and control as before, but as a source of revenue.<sup>(2)</sup>

#### Argentina:

The Argentine provinces impose taxes on profitable activities, or "impuestos a las actividades lucrativas", in the form of proportional rates on annual gross receipts. These taxes are, in fact, a transformation, under pressure of financial need of the previous provincial license taxes, or "impuesto de patentes" (i.e. fixed fees for the "privilege" of

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(1) Perry, Harvey J. : "Taxation in Canada".  
Toronto, 1951. p.33.

(2) Brittain, Horace : "Local Government in Canada".  
Toronto, 1951. p.98.

doing business). The latter sometimes also co-exist with the former as in the Province of Corrientes.<sup>(1)</sup>

In the latter province, therefore, there is a business tax, affecting a progressive structure, ranging from 0.04% to 3% on gross receipts ranging from 5,000 pesos to 50,000 pesos. In addition, there is a fixed license payable by all provincial concerns, based on the value of commodities owned at the time of payment. The tax rates range from 50 pesos for businesses with commodities valued at less than 1,000 pesos, to 6,200 pesos when the value of the commodities is between 950,000 pesos and 1,000,000 pesos. A supplementary tax of 2% per 1,000 pesos is levied when the commodities are worth more than a million pesos.<sup>(2)</sup>

In the Province of Buenos Aires, a profitable activities tax is imposed. The law of 1948 provides for a basic tax of 4% per 1,000 pesos of gross receipts. Gross receipts below 10,000 pesos are exempt. Manual, intellectual and other salaried labour, as well as agriculture, are excluded from the scope of the tax. Deductions, ranging from 10 per cent to 80 per cent are allowed, on the basic rates, to some activities,

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(1) The definition of "license tax" may be still in use, misleadingly, to denote the new taxes as, for instance, in the Province of Tucuman.

(2) Patterson, Ernest F. : "Argentine Provincial Tax Systems". Inter-American Economic Affairs. Winter, 1953. p.57.

e.g. the manufacturing of agricultural machinery, wholesale dealers in food and cereals. On the other hand, recharges are sometimes imposed, for instance, in the case of banks, commercial advertising, auction sales, and various commissioners, and intermediaries and pawnbrokers.

The city of Buenos Aires recently resorted to a similar tax. This was conducive to a great deal of interjurisdictional overlapping which will be referred to, in some detail, in due course.<sup>(1)</sup>

The types of transfer taxes are discernible, the separate "inheritance or succession tax". The former is levied on the entire estate before distribution. The latter

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(1) See Chapter Two on "Overlapping and Multiplicity", Section IV, "Local Business Taxation".

## SECTION IV

### Local Death Taxation

#### Introduction

The modern history of death taxes does not go back very far. When they were first resorted to in unitary countries they were confined to the central level as occurred in Britain in 1894. However, in federal countries the opposite development took place. In fact, the traditional pattern of federal constitutions used to empower the lower layers to levy direct taxes, whilst the indirect taxes were left to the federal government. The pressure of financial need forced the subordinate units to adopt new forms of direct taxation besides real estate taxation, such as corporate and personal income taxes and death taxes.

Two types of transfer taxes are discernible; the "estate tax" and the "inheritance or succession tax". The former is imposed upon the entire estate before distribution. The latter is based on the share accruing to the individual successor.<sup>(1)</sup>

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(1) The two taxes amount sometimes to the same thing as when the deceased leaves specified sums to particular beneficiaries. The balance of the estate thus pays the inheritance tax together with the estate tax and the final incidence falls on the residual beneficiaries who are often close relatives. The succession tax actually falls on the beneficiary if the testator leaves certain proportions to his beneficiaries instead of specified amounts. The succession tax thus becomes distinguishable from the estate tax.



The estate and inheritance taxes, as used by lower authorities, are now mainly found in federal countries.<sup>(1)</sup>

In the U.S.A., the death taxes were adopted by the states especially before World War I and notably between 1892-1916. The Federal Government, which used them only in emergencies,<sup>(2)</sup> definitely adopted them in 1916. At the onset of World War II (in 1941) there were 47 states in the field accounting for about 23 per cent of total federal-state revenue of 529 million. The present situation can be summarized in that the estate tax is used on the federal level and sometimes on the state level as an independent or differential levy, besides or in place of the inheritance tax. The latter is, however, the most used by the states.

In Canada, the death taxes were never a source of federal revenue until 1941. The "succession duties" were in fact first levied in 1892 by Ontario, Quebec, New Brunswick, Nova Scotia and other provinces followed suit. The confusion and injustice which ensued were intolerable. The post-war agreements which federalized these taxes, still left Quebec and Ontario in the field.<sup>(3)</sup>

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(1) In England, after the repeal of the legacy duty in 1948, there remained only the estate tax on the central level.

(2) The emergencies are 1797-1802, 1862-1870, 1898-1902.

(3) Perry, Harvey : Taxation in Canada. Toronto, 1951. p.29

The Canadian death taxes are a hybrid combination of the British estate tax and the American state inheritance taxes. They are, in principle, succession duties levied according to the amount of the individual succession and the relationship of the beneficiary to the deceased but they also take into consideration the size of the total estate.<sup>(1)</sup>

In Australia, the estate duties are imposed by both the Commonwealth government and the state governments.

In Argentina, inheritance taxes and gift taxes are levied by the provinces since their very existence.

Brazil and other federations could be also mentioned.

The resort to death taxation by both junior and senior authorities, is conducive to various forms of intra-local, inter-local and central-local fiscal inequities and inequalities which are referred to below.

Progression is generally used in the estate taxes according to the size of the estate. It may however be questioned. The rich, inheriting the whole of a small bequest may receive more, after tax, than poorer successors inheriting the same gross amount as a small portion of a large bequest.

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(1) Perry, Harvey : op. cit. p.103.

(2) Macneil, Paul : "The Proper Sphere of Death Taxes". in The Annals of the American Academy of Political and Social Science. January, 1936. p.86. See also:

Taylor, Philip : "The Economics of Public Finance". New York, 1943. pp.493-504.

## I. Intra-Local Fiscal Inequity.

In the writer's view, the death taxes of both types (estate and inheritance taxes) are justifiable, when used on the central level, on grounds of ability to pay. The principles of "benefit", "state partnership" or "back-tax" are not satisfactory.

The benefit principle, according to which the government must be paid for services rendered in guaranteeing the distribution of estates to the heirs, can only motivate probate fees. The second principle falls short of explaining the exemption of small estates or the progression in the taxes. The third principle is a crude method of coping with, or penalizing, evasion<sup>from income taxation</sup>. As for the theory of wealth redistribution, it is not inherently compatible with the theory of ability to contribute.<sup>(1)</sup>

Progression is generally used in the estate taxes according to the size of the estate. It may however be questioned. The rich, inheriting the whole of a small bequest may receive more, after tax, than poorer successors inheriting the same gross amount as a small portion of a large bequest.

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(1) Haensel, Paul : "The Proper Sphere of Death Taxes". in The Annals of the American Academy of Political and Social Science. January, 1936. p.86. See also:

Taylor, Philip : "The Economics of Public Finance". New York, 1948. pp.495-504.

From the fiscal equity point of view, progression is better suited for inheritance taxes. A rational graduation in this case should however relate to the total ability to pay of the heir, in other words his total net income, rather than the amount of the share transmitted to him, besides his relationship to the deceased.

Now, if the death taxes are adopted on the local level, two infringements of fiscal equity take place. The progression, which the subordinate units most probably use, will be distorted either in the case of the estate tax or the inheritance tax. In the former case, for instance, the progression would not be justifiable unless it applies to the total value of the estate, but the taxing locality may not be able to tax real or personal property or intangibles located in other local areas.

The second source of injustice stems from the fact that real property, intangibles or other items of a bequest, may be dispersed over diverse localities and can thus be subject more than once to taxation. This is a case of overlapping leading to over-taxation which will be more fully expounded later.

- (2) After the introduction of the federal credit of \$30,000 in 1938, several states try to get the full benefit of the credit by using the estate tax as a "deficiency levy" to take up the part of the credit left unabsorbed by the state's inheritance tax. See: *Marshall, James: "The Fiscal Impact of Federalism in the United States."* Cambridge, Massachusetts, 1945, p. 345.
- (3) Gift taxes, whether on the federal or state level, should be integrated with death taxes since they duplicate exemptions and allow the estate owner to escape the upper brackets rates of taxation.



## II. Inter-Local Fiscal Inequity:

The lack of inter-area uniformity in definitions, exemptions and rates may usher in various sorts of inequalities within the same country. Indeed, all local units (especially in federations) may not adopt the same patterns of death taxes. Some may levy estate taxes, some may levy inheritance taxes, some may combine both and some others may abstain, for one reason or another, from levying any kind of taxation at death.<sup>(1)</sup> Exemptions for direct and collateral heirs may vary from locality to locality. Inter-area differences in rates may exist; the rates being low or high, proportional or progressive.

In the U.S.A. there are many inter-state differences in the tax burden. Some states levy inheritance taxes, some have estate taxes, others combine both<sup>(2)</sup> and others still have none (one state at present). The state gift taxes seem to be gaining momentum since they were first enacted by Wisconsin and Oregon in 1933. By 1942, twelve states levied gift taxes.<sup>(3)</sup>

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(1) For instance, to encourage the flow of high incomes and high income-receivers into the locality

(2) After the introduction of the federal credit of 80% in 1926, several states try to get the full benefit of the credit by using the estate tax as a "deficiency levy" to take up the part of the credit left unabsorbed by the state's inheritance tax. See: Maxwell, James : "The Fiscal Impact of Federalism in the United States." Cambridge, Massachusetts, 1946. p.343.

(3) Gift taxes, whether on the federal or state level, should be integrated with death taxes since they duplicate exemptions and allow the estate owner to escape the upper brackets rates of taxation.

U.S.A.Types of State Transfer Taxes, January 1942.<sup>(1)</sup>

Types of Transfer Taxes	State
(1) Inheritance Tax Only.	Idaho, Illinois, New Mexico, South Dakota, West Virginia, Alaska, Wyoming.
(2) Estate Tax based on Federal Levy.	Alabama, Arizona, Arkansas, Florida, Georgia, Mississippi, New York.
(3) Inheritance and Differential Estate Tax.	Connecticut, Delaware, Indiana, Iowa, Kansas, Kentucky, Maine, Maryland, Massachusetts, Michigan, Missouri, Montana, Nebraska, New Hampshire, New Jersey, Ohio, Pennsylvania, South Carolina, Texas, Vermont, District of Columbia, Hawaii.
(4) Inheritance and Differential Estate Tax; also Gift Tax.	California, Colorado, Louisiana, Minnesota, North Carolina, Tennessee, Virginia, Washington, Wisconsin.
(5) Inheritance and Independent Estate Tax; Also Gift Tax.	Oregon.
(6) Independent Estate Tax.	North Dakota, Utah.
(7) Independent and Differential Estate Tax; also Gift Tax	Oklahoma.
(8) Inheritance, Independent & Differential Estate Tax.	Rhode Island.
(9) No Transfer Tax.	Nevada.

(1) "Federal, State and Local Government Fiscal Relations" 78th Congress, 1st Session. Senate Document No.69 Washington, 1943. p.473.

As for the exemptions, the direct heirs are dissimilarly treated being either totally exempt (e.g. New Hampshire) or enjoy varying degrees of exemption. The collateral heirs, too, are in unequal positions as regards exemptions. If in some states they get a small exemption, in others they get none. The variations in exemptions, sometimes allowed to them, range from \$ 100 or \$ 200 or \$ 500 to \$ 1,000 or \$ 5,000. The rates of taxation also exhibit differences from state to state. In the case of direct heirs, they range from 1% to 16%. As for collaterals, they range from 2% or 4% to 40%.<sup>(1)</sup>

The effective state death tax rates on an estate of \$ 1,000,000 varied, in 1937 from 3.24 per cent in Pennsylvania to 11.05 per cent in North Dakota.

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- (1) Lutz, Harley Leist : "Public Finance" New York, 1936. p.661. See also:  
Buehler, Alfred : "Public Finance". New York, 1948. p.396

(1) Oakes, Eugene : "The Federal Defeat and the American Death Tax System". In The Quarterly Journal of Economics. August, 1940. p.576.

Diversity of State Death Taxes in U.S.A. (1)

Type of Tax Used.	Number of Jurisdictions		
	1925	1932	1939
1. <u>Inheritance Taxes Only:</u>	41	13	7
1- Flat rate on collaterals	2	0	0
2- Flat rate on collateral and direct heirs.	3	2	2
3- Flat rate on direct and progressive rates on collateral heirs.	1	0	0
4- Progressive rates on direct and flat rates on collateral heirs.	1	0	0
5- Progressive rates on both direct and collateral heirs.	34	11	5
2. <u>Estate and Inheritance Taxes Used Jointly with inheritance taxes of the following varieties:</u>	3	27	33
1- Flat rates on collaterals.	0	2	1
2- Flat rates on collateral and direct heirs.	1	1	2
3- Flat rates on direct, and progressive rates on collateral heirs.	0	1	1
4- Progressive rates on direct and flat rates on collateral heirs.	0	1	1
5- Progressive rates on collaterals	0	1	1
6- Progressive rates on direct and collateral heirs.	2	21	27
3. <u>Estate Tax Only.</u>	2	7	8
4. <u>No Tax.</u>	3	2	1
Grand Total	49	49	49

(1) Oakes, Eugene : "The Federal Offset and the American Death Tax System". in The Quarterly Journal of Economics. August, 1940. p.576.



## U. S. A.

Effective Death Tax Rates in Selected States1937 (1)

State	Net Estate Before Specific Exemption \$							
	50,000	100,000	300,000	500,000	1,000,000	5,000,000	10,000,000	50,000,000
	%	%	%	%	%	%	%	%
Kentucky	1.53	2.63	5.17	6.30	7.90	11.80	13.51	15.48
Montana	1.90	2.65	4.72	6.11	8.01	10.56	10.88	14.92
North Dakota	.80	2.28	5.93	7.77	11.05	20.25	21.63	22.73
New York	.25	.55	1.42	2.29	3.88	9.68	13.27	18.65
Oregon	1.85	2.88	5.84	7.51	10.75	17.55	18.53	19.31
Pennsylvania	3.22	3.23	3.24	3.24	3.24	7.74	10.62	14.92
Utah	3.40	4.95	8.15	8.89	9.45	9.89	9.94	9.99
West Virginia	2.51	3.42	3.92	4.38	5.41	9.09	10.82	13.09
Wisconsin	1.98	2.69	4.73	5.12	8.01	11.56	10.62	14.92

(1) "Federal, State and Local Government Fiscal Relations".  
op. cit. p.490.

Bushler, Alfred: "Public Finance". op.cit. p.396 & p.398

### III. Central-Local Fiscal Inequity.

The inequity of local death taxes may stem from another source, namely a duplication of the same taxes on the central level. Injustice assumes more importance as the burden of such taxes increases on both levels of taxing jurisdiction. This has been noticeably the case after World War I.

The U.S.A. afford an illustration. The states were alone in the field before 1916. The invasion by the Federal Government meant of course an additional burden. However, at the beginning the dual burden was light. Indeed the rates were low and the exemption limits were high in state and federal taxation alike.<sup>(1)</sup> Moreover, the states used to compete to attract wealthy residents by emulative lightening of the burden or its total abolition as occurred in Florida and

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(1) The states levied only inheritance taxes. The latter hit collateral heirs, rather than direct heirs, and the property received by non-residents. The rates were flat till the beginning of the present century, and the exemption limits were high. The Federal estate tax of 1916 was graduated from 1 to 10 per cent on net estates above \$ 50,000, the maximum rate applying to estates in excess of \$ 5,000,000. The subsequent rises of 1917, 1918 and 1924 were not intense especially that a credit device was introduced in 1924 and 1926. It is the act of 1932 and those of 1934 and 1935 which really increased the burden not only because the rates were increased, but also because the credits were not available against these new supplementary federal estate taxes as will be seen later. The Second World War caused further increases. See:  
Lutz, Harley Leist : "Public Finance". op.cit. pp.665-667.  
Buehler, Alfred : "Public Finance". op.cit. p.390 & p.395

Nevada which had both passed constitutional amendments in 1924 and 1925 respectively forbidding the enactment of inheritance taxes. (1)

At the present time, the situation is different. The federal exemption limits were lowered and the rates put up. In 1946 the exemption was \$ 60,000 and the rates were graduated from 3% on the first \$ 5,000 of taxable estate up to 77% on the excess of taxable estate above \$ 10,000,000. (2) Furthermore, to avoid evasion, a federal gift tax was grafted on the estate taxes (from 1924-26 and again beginning in 1932). The rates in 1946 were three-fourths as large as those ruling in the estate tax.

Similar tendencies are noticeable in state taxation.

It is however possible to avert the dual national-local burden by deducting from the national tax an amount equivalent to the local levy. The advantage is to make possible that the maximum burden of death taxes will be the one imposed by the central government whatever the local levies are.

The tax credits may be comprehensive or partial. They may absorb all or part of the local transfer tax. In the latter

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(1) Maxwell, James : op.cit. p.333.

(2) Allen, Edward and Brownlee, O.H. : "Economics of Public Finance." New York, 1947. p.351.

case, they may affect the form of lump sums, fixed or graduated, or affect the form of proportions computed on the basis of the central or the local taxes.

Apart from the revenue advantages of the tax credits to the subordinate units, they militate in favour of personal fiscal equity and of inter-local fiscal equity by mitigating the combined central local tax burden. Clearly, the comprehensive tax credit performs that role best.

Local death tax progression can however be adversely affected by the formula of the credit. This occurs if the tax credit takes the form of a fixed amount or is a fixed proportion of a central tax with wide brackets whilst the brackets in the local transfer tax are narrow as they generally tend to be especially in the lower groups.

In some countries a peculiar disfiguring of the tax credit may lead to a distortion of local and central-local progression combined,<sup>(1)</sup> as will be expounded further.

In the U.S.A., to which we may refer for clarification, the federal-state tax burden was actually alleviated in 1924 through a credit granted up to 25 per cent of federal estate tax liability, for the payment of any state death tax. In 1926 the credit was raised to 80% thus reducing the federal death tax yield by the same extent.

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(1) Maxwell, J.A. : op.cit. p.351.



It is noticeable that the mitigation of the total tax burden was palpable as long as the federal taxes were low and the state taxes were high and as long as the credits were applicable to the current federal estate tax provisions and not to outdated ones. However, this was no more the case when the federal taxes soared (notably since 1932 and World War II) and when the state taxes' percentages of the total federal-state burden decreased and especially after the credit device was distorted as will be seen in next point.

#### Federal and State Revenue from Death Duties

##### Percentages (1)

Year	Percentages		Year	Percentages	
	Federal	State		Federal	State
1924	55	45	1929	29	71
1925	53	48	1930	26	74
1926	55	45	1932	25	75
1927	47	53	1937	73	27
1928	31	69	1938	74	26
			1941	77	23

- (1) Combined from Oakes, Eugen "The Federal Offset and The American Death Tax System." op.cit. p.574 and Maxwell, James, op.cit. p340.

#### IV. Fiscal Inequities and Experience.

##### 1. The U.S. Crediting Device

The credit device of 1926 aimed at redressing the fiscal inequity inherent in a dual tax burden (federal and states) and inter-state heterogeneity in death taxation. In fact it was thought that the states, in an attempt to absorb the whole credit, would shift from inheritance taxation to estate taxation, in conformity with the federal government, and would adopt the same definitions as the latter with regard to domicile, situs and other provisions. The states, it was hoped would cease competing for wealthy residents. The non-taxing states would be induced to levy transfer taxes. In sum, inter-state uniformity would be established.

These objectives did not materialise. The crediting device fell short of coping with the problems of central-local and inter-local fiscal inequities. First, the credits do not include the whole state taxes. The Federal Government in 1926 decided to share its tax in the ratio of 1 to 4 (i.e. 80%).<sup>(1)</sup> Second, this ratio applies now, not to the current Federal estate tax, but to a tax structure no more existing. Indeed,

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- (1) Strictly speaking, the Federal Government does not share the tax with the states, but allows the credits to the taxpayers. It is up to the states to impose and collect their own transfer taxes.

For a lucid exposition of the crediting device see:  
Oakes, Eugene : "The Federal Offset and The American Death Tax System" *Quarterly Journal of Economics*, August 1940. pp.566-598.

Maxwell, James : op. cit. pp.337-353

Groves, Harold : "Viewpoints on Public Finance". New York, 1945. p.42.

in 1932, 1934, 1935 and in World War II the Federal tax was increased substantially. The exemption limit was brought from \$ 100,000 to \$ 50,000 then to \$ 40,000 (in 1942 the exemption was \$ 60,000 as already mentioned but the exclusion of \$ 40,000 for insurance was cancelled). The rates were raised.

Percentage Increase in Federal Estate-Tax Rates. (1)

Net Estate after Specific Exemptions	1926	1941	Percentage Increase	Net Estate after Specific Exemptions	1926	1941	Per- centage In- crease
\$				\$			
10,000	1.0	5.0	400.0	500,000	3.5	29.1	732.6
25,000	1.0	9.2	820.0	1,000,000	4.9	32.6	571.5
50,000	1.0	14.0	1,300.0	5,000,000	10.7	49.4	390.2
100,000	1.5	20.7	1,280.0	10,000,000	13.5	60.9	349.8
250,000	2.6	26.3	911.0	50,000,000	18.7	73.8	294.4

In spite of the change in the Federal tax structure, the credits still applied to the light tax of 1926 thus denying to the state the benefits of the more remunerative Federal so-called "supplementary tax". The Federal gift tax of 1932, by encouraging the distribution of wealth inter-vivos was a further cause of weakening of the yielding capacity of the

(1) "Federal, State and Local Government Fiscal Relations".  
op.cit. 485.  
The specific exemption was \$ 100,000 in 1926 and  
\$ 40,000 in 1941.

death taxes to the states.

The outcome of the new position is that no credits are allowed for net estates of \$ 100,000 and less which form the bulk of the estates. Moreover, as the Federal rate increases affect the higher brackets more than the lower brackets, the relative share of state transfer taxes enjoying credit decreases steadily with the increase in the value of the estates. In other terms, the states are deprived of the credit at the lower and upper ends of the scale.

Maximum Federal Credit Under 1926 Act as Percentage of Federal Tax at 1941 Rates and Exemptions. (1)

Net Estate Before Specific Exemption	Total Federal Tax 1941	Maximum Federal Credit for State Tax Paid	Credit as Percentage of Total Federal Tax.	Net Estate Before Specific Exemption	Total Federal Tax 1941	Maximum Federal Credit for State Tax Paid	Credit as Percentage of Total Federal Tax
\$	\$	\$	%	\$	\$	\$	%
\$0,000	1,600			200,000	38,700	1,200	3.1.
\$0,000	4,800			400,000	100,900	6,800	6.7
\$0,000	9,500			600,000	166,700	14,000	8.4
\$0,000	15,100	160	1.1	1,000,000	310,900	33,200	10.7
\$0,000	23,700	400	1.7	4,000,000	1,814,600	280,400	15.5
				10,000,000	6,057,800	1,067,600	17.6

The arithmetic average of the tax credit is thus about 11 per cent instead of the original 80 per cent.

(1) "Federal, State and Local Government Fiscal Relations" op.cit. 487.  
Also, Maxwell, James : op.cit. p.344 (marginal notes and table.



Important inferences can now be made in connection with fiscal equity in U.S. state death taxation:-

- 1- Personal Fiscal Inequity: The lower brackets or smaller estates either do not benefit from the tax credit at all (\$ 100,000 or less) or benefit proportionately less than larger estates. This militates against the progression of the combined federal-state tax burden. The credits should be graduated in such wise as to give larger percentage credits on small estates and smaller percentages on larger estates.<sup>(1)</sup>
- 2- Inter-State Fiscal Inequity: In the general scramble for revenue, the states absorbed the whole credit, and even exceeded it. In doing so they did not follow a uniform pattern as was expected. Instead of copying the Federal estate tax and adopting its provisions as concerns domicile and situs, they increased the confusion. Some enacted a differential estate tax, grafted on their inheritance tax. Some resorted to an independent estate tax, sometimes in addition to their inheritance tax. Other states simply intensified the latter. State gift taxes were also added to the picture. Furthermore, there were inter-area differences in exemptions and rates. As a matter of fact, inter-state fiscal inequalities were accentuated.<sup>(2)</sup>

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(1) "Conflicting Taxation", 1935 Progress Report of the Interstate Commission on Conflicting Taxation. Council of State Governments, Chicago, 1935. pp.114-118.

(2) Oakes, Eugene : "The Federal Offset and The American Death Tax System". op.cit. pp.577-580.

U.S.A. : Inter-State Fiscal Inequalities.(1)

Example 1 - Estates Passing to Widow.

Size of Estate \$	Mean Rate (Percent)		Standard Deviation (Percent)	
	1925	1939	1925	1939
50,000	1.0	1.1	$\pm$ .7	$\pm$ .9
200,000	2.3	2.7	1.4	1.8
1,000,000	3.7	5.0	2.3	2.9

Example 2 - Estates Passing to a Stranger.

Size of Estate \$	Mean Rate (Percent)		Standard Deviation (Percent)	
	1925	1939	1925	1939
50,000	7.0	7.0	$\pm$ 3.7	$\pm$ 4.2
200,000	10.4	9.9	5.5	6.7
1,000,000	13.8	13.9	8.4	9.6

(1) Oakes, Eugene : "The Federal Offset and The American Death Tax System." op.cit. p.579.

3- Federal-State Fiscal Inequity: The combined Federal-State tax burden tend to be repressive because both layers co-exist and because the crediting device is quite unsatisfactory. The latter can give partial relief or total relief according to whether it offsets part of, or all, the taxes payable to the subordinate jurisdictions. However, the credits, as they are now, make no sense since they apply to an outdated federal tax structure.

Combined State and Federal Tax as Percentage of  
Net Estates (Before Specific Exemptions) (1)

State	\$50,000	\$100,000	State	\$50,000	\$100,000
	%	%		%	%
Kentucky	2.53	12.13	Oregon	2.85	12.38
Montana	2.90	12.15	Utah	4.40	14.45
N.Dakota	1.80	11.78	Wisconsin	2.98	12.19
Oklahoma	1.90	11.70			

The combined federal-state burden can be better appreciated if this table is compared with a previous table giving the effective death tax rates in selected (the same) states.

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(1) The state taxes are based on data of 1937. The Federal tax is computed at 1941 rates and with specific exemption of \$40,000. See:-  
"Federal, State and Local Government Fiscal Relations."  
p.486.

## 2. Canadian Provincial Death Taxes.

In Canada, there were marked inter-provincial fiscal inequalities before World War II when death taxes were the most important source of provincial revenue.

After the War, Dominion-provincial Tax Rental Agreements were reached resulting in the appropriation of the death taxes by the Dominion government and their repeal in the provinces, save however for the two wealthiest ones, viz: Quebec and Ontario. According to the agreements lasting till March 1952, the Dominion government allows a credit up to one-half of the federal tax liability against taxes paid to the province, thus alleviating the central-local fiscal burden.<sup>(1)</sup>

Inter-area fiscal inequalities still however exist at the present time between the two important provinces of Quebec and Ontario which resort to separate transfer taxes besides those imposed by the Dominion. There are disparities between the two provinces in exemption limits and rates for all classes. The existence of a double-deck tax burden (Dominion and provincial) on transfers in these provinces leads forcibly to a relatively heavier fiscal inequity in them besides the fiscal inequalities between them.<sup>(2)</sup>

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(1) Perry, Harvey : Taxation in Canada.  
Toronto, 1951. p.29, p.188.

(2) Perry, Harvey : op.cit. Appendix, tables XVI and XVII  
pp.357-362.



## CANADA

I. Inter-Provincial Differences in Rates.

(Widow Only) (1)

Aggregate Net Value	Federal Duty	Quebec	Ontario
		Provincial Duty	Provincial Duty
\$	%	%	%
20,000	-	2.80	-
25,000	-	3.00	-
50,000	-	4.00	-
60,000	10.60	5.60	4.60
100,000	14.70	8.00	7.50
300,000	26.70	12.00	10.00
500,000	32.70	15.50	12.50
1,000,000	38.70	23.00	18.00

(1) Perry, Harvey : op.cit. Appendix, tables XVIII and XIX  
p.363 & p.364,

## II. Inter-Provincial Differences in Combined

### Dominion-Provincial Tax Burden (Widow Only).<sup>(1)</sup>

The Effect of Tax Credits Taken Into Account.

Aggregate Net Value	Dominion + Quebec	Dominion + Ontario
\$	\$	\$
20,000	560	-
25,000	750	-
50,000	2,000	-
60,000	7,140	5,294
100,000	13,880	14,505
300,000	74,760	74,760
500,000	156,960	156,960
1,000,000	419,630	396,630

and Cervigatos. Inter-provincial disparities in rates exist in certain categories of beneficiaries.<sup>(2)</sup>

#### General Appraisal

Our analysis suggests that the transfer taxes should be confined to the central level and referred to the underlying units. The problems involved in local death taxation are so

(1) Perry, Harvey: op.cit. Appendix, tables XVIII and XIX p.363 & p.364. Economic Affairs, Winter, 1953, No. 3, pp.58-60.

(2) Anales de Legislación Argentina, Vol.IX-B, 1949 and A, No XI, No.59, December 14, 1951.

### 3. Argentine Provincial Death Taxes:

The tax rates for the different values of legacies and different degrees of relationship to the deceased, vary from province to province.

In the Province of Buenos Aires, the rates are much higher than in other provinces with the exception of Tucumán and Salta.<sup>(1)</sup>

If the rates in Tucuman are lower than those of Buenos Aires for the first class of beneficiaries they are slightly higher for the last classification.

The rates of Salta are the same as Buenos Aires but somewhat lower in the case of parents, spouses and children.

In all other provinces, the tax rates are considerably lower. The provinces are Jujuy, Mendoza, Santa Fe, Córdoba and Corrientes. Inter-provincial disparities in rates exist in certain categories of beneficiaries.<sup>(2)</sup>

### General Appraisal:

Our Analysis suggests that the transfer taxes should be confined to the central level and refused to the underlying units. The problems involved in local death taxation are so

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(1) Patterson, Ernest F. : "Argentine Provincial Tax Systems". Inter-American Economic Affairs. Winter, 1953, No.3. pp.59-60.

(2) Anales de Legislación Argentina, Vol.IX-B, 1949 and Año XI, No.39, December 14, 1951.

acute that they amply justify this course. Commenting on the American situation, two authorities stated that; "Among major state taxes none is more poorly administered than the death tax whether judged by principles of organisation, by equity of application or by available quantitative measures."<sup>(1)</sup>

In the writer's view, the administration of the death taxes should be definitely centralized. Some form of tax sharing may be adopted. However, this is the subject-matter of a concluding chapter.

Suffice it to point out here to the flagrant inadequacy of the American crediting device and the necessity of drastic reform in order to enhance inter-state uniformity and achieve fiscal equity. The credit should refer to current federal death taxation. The subordinate units must be forced to comply with federal definitions of domicile and situs. It was proposed to fix the credit at 50% of federal liability on the amount of net estate not exceeding \$ 100,000 and 25% on amounts exceeding \$ 100,000.<sup>(2)</sup>

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(1) Heller, Walter and Harris, Lowell : "The Administration of State Death Taxes", Iowa Law Review. March, 1941. pp.628-673.

(2) "Federal, State and Local Government Fiscal Relations." op.cit. 490.



## SECTION V.

### Local Outlay Taxes.

#### Introduction.

The underlying units of government, in unitary and federal countries, find in the outlay taxes a lucrative source of revenue. These minor jurisdictions, are clearly precluded from imposing customs duties whose centralisation is a prerequisite of economic union, the necessary concomitant of the political union achieved. However, other taxes on expenditures can be resorted to. In many federal countries the secondary governments, states provinces or regions, and often the tertiary authorities, can levy a wide assortment of taxes on outlay notably sales taxes, whether general or specific.<sup>(1)</sup>

Commenting on the recent spread of the sales taxes, Professor Haig and Professor Shoup state that:

"In the history of public finance no other tax, save perhaps the one on gasoline, has spread so swiftly over the world."<sup>(2)</sup>

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- (1) "Sales taxes" is here a generic term connoting a wide variety of general and specific taxes imposed at various stages; production, wholesale, retail.
- (2) Haig, Robert Murray and Shoup, Carl :  
The Sales Tax in the American States. New York, 1934. p.5.

In the U.S.A., there are general sales taxes on the production and merchandising stages. There are also specific sales taxes notably on liquor, tobacco, gasoline and motor-vehicles. They are imposed by the states, local authorities and cities. (1).

In Canada, general and specific sales taxes are also resorted to. Besides the provincial gasoline and special tobacco taxes there are retail sales taxes in provinces, for instance Quebec, New Brunswick, Newfoundland, British Columbia, and municipalities such as Montreal, Quebec City and other cities in the province of Quebec. (2)

The local sales taxes are also spreading to some European countries after the Second War, e.g. Greece

### U. S. A.

#### Sales Tax Burden Per Capita in Selected States, 1940. (3)

State	Per Capita
	\$
California	14.27
Michigan	11.51
South Dakota	7.03
Ohio	6.69
North Carolina	3.43

(1) See Part One, Chapter II, Section VI.

(2) Perry, Harvey J. : Taxation in Canada, Toronto, 1951. p.33.

(3) Somers, M. Harold : "Public Finance and National Income." Philadelphia, 1949. p.410.

U. S. A.The Regressivity of the Sales Tax

Approximate Amount per \$1,000 of  
Income a General Sales Tax Takes  
From Different Income Groups. (1)

Income	Amount Taken Under a 2% Tax.	Amount Taken Under a 3% Tax.
\$	\$	\$
1,000 and under	12.18	18.27
1,000 - 2,000	11.72	17.58
2,000 - 3,000	9.88	14.82
3,000 - 5,000	8.58	12.87
5,000 - 10,000	7.86	11.79
10,000 - 25,000	6.34	9.51
25,000 - 50,000	4.44	6.66
50,000 - 100,000	3.68	5.52
100,000 - 150,000	3.10	4.65
150,000 - 300,000	2.42	3.63
300,000 - 500,000	.84	1.26
500,000 - 1,000,000	.50	.75
1,000,000 and over	.20	.30

- (1) The Home Owner and The Sales Tax.  
Tax Policy League. New York, 1935. p.6.

In India, the sales taxes, which were first resorted to by Madras just before World War II (in 1939-1940), have now spread to all ex-provinces of British India. At first the taxes were mild and did not involve food stuffs and other necessities or raw materials used in industry. However, in several states, these items are now taxed<sup>(1)</sup> and the tax rates are generally rising.

In 1949, the Federal Government proposed the transfer of the sales taxes to the central level, against annual compensation, but met with much opposition from the different states whose rights to sales taxation have been confirmed in the Constitution (the sales tax on newspapers is however centralized).

### INDIA

#### Revenue from Sales Taxes

(Rs.crs.) (2)

State	1946-47	1949-50	State	1946-47	1949-50
Madras	7.22	12.45	Bihar	.78	3.14
Bombay	1.60	9.45	Central Provinces & Berar.	-	1.75
Bengal	3.60	4.00	Assam	-	.20
United Provinces.	-	6.00	Orissa	-	.57
Punjab	.12	.74	Total	<u>13.32</u>	<u>38.30</u>

(1) The same state may differentiate between luxuries and necessities, e.g. Bihar and Madras.

(2) United Nations : Public Finance Surveys, India.  
New York, 1951. p.74.



It is noteworthy that the resort to sales taxes on the local level is likely to be abused in countries, notably underdeveloped, where the politico-social structure is feudalistic, aristocratic or oligarchic. It is to be feared that the wide adoption of outlay taxes by the intermediate or tertiary authorities in the newly formed federations of backward areas might conduce to more fiscal inequities and inequalities.

### **I. Fiscal Inequities and Inequalities:**

The fiscal inequities and inequalities, in their intra and inter-local aspects, which inhere in the locale sales taxes, can be appreciated with reference to industry, business and consumers.

#### **1. Industry and Business:**

The general sales taxes, on gross receipts of manufacturers or wholesalers, bear no relation to the amount of net profits. They mean either low or high effective rates according to the amount of net profits realised. This is due to the existence of differences, between the various concerns, in capital investments, indebtedness, losses and other factors. The tax also discriminates against new and small enterprises which realise low profits relative to sales and are more exposed to losses than large and well established concerns.<sup>(1)</sup>

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(1) Buehler, Alfred G. : "The Pros and Cons of General Sales Taxation." Current Problems in Public Finance. New York, 1933. p.244.

Similarly, it is noticeable that the local uniform rate structure, in the case of the general or retail sales taxes, is discriminatory, between concerns, on account of the differences in turnover, the varying proportions of gross receipts or profits to capital invested, the differences in marketing processes and the degree of integration.<sup>(1)</sup>

In the case of the selective sales taxes, some local industries or businesses will be able to shift the tax forward to the consumers, while others may be unable to shift owing to the competition of similar or substitute commodities "imported" from adjoining non-taxing localities. Demand in the taxing area, in this case, becomes relatively elastic, and hinders forward shifting.

It is to be mentioned that the integrated and inter-local concerns will be favoured. Multiple-process businesses will be at an advantage compared to single-process businesses. Integration mitigates the effects of pyramiding. The inter-local concerns can compensate the tax paid to a given taxing jurisdiction by profits realised within another non-taxing jurisdiction. Inter-local businesses can also divert orders to extra-local branches.

The unequal treatment of local industrial and business activities can be further exemplified by reference to the

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(1) These points are further developed from another point of view in Part Two, Chapter IV, "Intergovernmental Fiscal Conflicts," Section I "Local Taxing Powers".

feature of mobility. In fact, while some industries can easily move out of the locality, others are not mobile such as the extractive industries (farming, forestry, mining). In case the adjoining areas are non-taxing, the latter industries, being unable to shift the tax forward will have either to bear it or to shift it backward.

As for the inter-local fiscal inequalities, they may be due to several factors. Simply, some localities may be taxing and the others may be non-taxing. This further involves discrimination against intra-local business compared with inter-local ones. Moreover, some local units may tax according to uniform rates while others apply variable or adjusted rates. The latter device is more in line with fiscal equity.

## 2. Consumers:

The sales taxes are generally shifted forward to the consumers. The degree of shifting depends on various factors such as the conditions of costs and the elasticity of demand and supply, the degree of monopoly and also the territorial coverage of the taxes.<sup>(1)</sup> If the sales taxes are not levied at the merchanting stage (wholesale or retail) they bring about an undue rise in prices through pyramiding. It is noteworthy that the shifting, in case the nearby areas are non-

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(1) Due, John F. : "Towards a General Theory of Sales Tax Incidence." The Quarterly Journal of Economics. May, 1953. p.253.

Hicks, U.K. : Public Finance. Cambridge, 1947. pp.161-185.

taxing, might affect the form of lower quality goods.

The local regressive impact of the sales taxes will be particularly felt if the commodities taxed are necessities such as foodstuffs. The latter are most likely to be taxed in view of their lucrative character to the subordinate governments.

However, the regressive impact will be mitigated if the adjoining areas are non-taxing. The demand for the local products will thus be relatively elastic and the local consumers, especially in the fringe taxing jurisdictions, will be able to procure tax-exempt products (or substitutes) either from multiple stores, or through outside purchases including postal shopping.

It is clear that tangible inter-local tax differentials manifest themselves on account of subsequent unequal rises in price levels <sup>on</sup> the co-existence of sales taxing and non-taxing localities. Furthermore, the urban and farm communities will not be similarly burdened. The former will be relatively more hit than the latter which are in a position to escape the taxes owing to direct consumption.

It is to be mentioned that the junior authorities may be driven to lay taxes on commodities "imported" from outside, in an effort to protect their domestic production and also to safeguard the revenue productivity of their consumption taxes.<sup>(1)</sup>

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(1) These taxes are actually levied by American states under the name of "use taxes". See:  
Jennings, Henrietta C. : "The Development of the Use Tax".  
American Economic Review. Dec. 1938. p.685.



The resort to these compensatory taxes, similar to the old tolls, militate against fiscal equity not only because outside cheaper or better products are precluded from crossing the local boundaries but also because the local residents may be paying the local compensatory levies in addition to the sales taxes imposed on the same commodities by the other localities; unless a sum equivalent to the "foreign" commodity tax is deducted from the domestic compensatory tax.<sup>(1)</sup>

## II. Progression and the Sales Taxes.

Some junior authorities may attempt to alleviate the regressive character of their consumption taxes. They would have recourse to various devices such as the exemption of foodstuffs, as in some American states, or the distinction between luxuries and necessities, as in some Indian states, e.g. Bihar and Madras, or the classification of commodities. Graduation may be even introduced through a system of bracketing according to the value of the sales or the amount of purchases during the year. The provision of refunds, to the low-income groups, for taxes paid on foodstuffs, could be also envisaged.<sup>(2)</sup>

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(1) Maxwell, James A. : The Fiscal Impact of Federalism in the United States. Cambridge, Massachusetts, 1946. p.301.

(2) In this case, however, administration would be very much complicated. See:  
Due J.F. : "The Sales Tax as an Anti-inflationary Measure."  
 Public Finance. International Quarterly. No.4, 1951.  
 p.392.

These devices are fraught with conflicts. The exemption of necessities or semi-necessities, although desirable from the standpoint of equity, prejudices the remunerative character of commodity taxation. As for graduation, it is not sound when applied to individual items of expenditure. As progression in the income taxes must apply to personal total net income, so is the case with consumption taxes. Graduation, in the latter must, logically speaking, apply to total annual personal expenditures or total disposable income minus funds not spent (after consideration of personal circumstances). However, such a tax is no more a sales tax but a direct graduated personal spendings tax which could only be properly adopted on the central level and would require a revision of the national tax system. (1) Professor Buehler suggests such a tax to be levied besides the normal person<sup>al</sup> income tax, possibly in place of the surtax. (2) Professor Fisher advocates it in place of the income tax.

Last, but not least, reference ought to be made to the fact that the progression of the national tax system as a whole may be seriously vitiated through substantial secondary and tertiary outlay taxes.

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(1) See Part Three, Chapter V, "Intergovernmental Fiscal Co-ordination", Section I, "The Local Taxes."

(2) Buehler, Alfred : "Taxing Consumer Spending."  
Bulletin of the National Tax Association.  
 January, 1954. p.123.

## CONCLUSION.

## CHAPTER TWO

### MULTIPLICITY AND OVERLAPPING.

Overlapping and multiple taxation, on the local level, within the boundaries of a country, can affect in two main forms: horizontal overlapping and vertical overlapping. Horizontal overlapping is either intra-local or inter-local. Vertical overlapping is essentially central-local. (1)

In other words, the term "multiplicity and overlapping" refers to the local taxes levied by the same locality, or between the local taxes levied by the different localities, or between local and national taxes.

Clearly, the amount of overlapping and multiple taxation varies in direct proportion to the amount of fiscal powers enjoyed by the lower tiers of government. It is less in centralized countries, whether over-centralized or under-centralized, than in federal countries, whether quasi-federations or real federations. Federalism, in fact, implies a further layer of government and the regional governments are established and organized and the governments of the states, each, within a sphere, co-ordinate and autonomous. In confederations, there may be even more overlapping.

The intensity of overlapping also depends on the form of the local taxation. In case of separate taxes, there

(1) Vertical overlapping may exist between intermediate and lower authorities.

### PRELUDE.

• Overlapping and multiple taxation, on the local level, within the boundaries of any particular country, can affect two basic forms; horizontal overlapping and vertical overlapping. Horizontal overlapping is either intra-local or inter-local. Vertical overlapping is essentially central-local.<sup>(1)</sup>

In other terms, duplicate taxation may occur between the local taxes levied by the same locality, or between the local taxes levied by the different localities, or between local and national taxes.

Clearly, the amount of overlapping and multiple taxation varies in direct proportion to the amount of fiscal powers enjoyed by the lower tiers of government. It is less in centralised countries, whether over-centralised or under-centralised, than in federal countries, whether quasi-federations or real federations. Federalism, in fact, implies a further layer of government and the regional governments are each, within a sphere, co-ordinate and autonomous. In Confederations, there may be even more overlapping.

The intensity of overlapping also depends on the forms assumed by local taxation. In case of separate imposts, there

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(1) Vertical overlapping may exist between intermediate and lower authorities.



is more scope for duplication than in tax-sharing or percentages on central taxes.

Fiscal equity can be seriously hindered by overlapping and multiplicity. A distortion of ability to pay may result not only from an undue burden laid on the taxpayer but also from the possibility of escape from taxation, either through loopholes or through income and capital flight to other localities where taxation is light or non-existent. Complete relief is sometimes an accompaniment of overlapping.

In modern economic conditions a divorce occurred between such elements as situs, residence <sup>and origin of income</sup> and place of work. Within the boundaries of the same country, there occurred a dissociation between "political allegiance" and "economic allegiance" to the junior authorities. An income-receiver may own real property in a local unit, reside in a second one and sell his labour in a third one. If he is participant in a business, or owns a business, the case becomes more complex. As a consumer, the local resident can also suffer from duplicate taxation. The problem may even appear after one's death, particularly in a federal polity.

If all the underlying taxing jurisdictions, in a unitary or federal country, adopt uniform tax provisions, much duplication would be averted. However, this is not always the case and the lack of fiscal harmony is especially flagrant in a federal structure of government.

In some countries inter-local double taxation is prohibited by the constitution as in Switzerland. The Federal Constitution of 1874, the law of 1885 and the Federal Tribunal in Switzerland all exert an influence in this direction.(1)

In the U.S.A. no constitutional provision or direct legal enactment dealt with the problem as states have inherent powers. However, such clauses as the Due Process of Law can be viewed as an indirect remedy. The court decisions afford sometimes a protection. Recently the Supreme Court took a long step away from judicial responsibility in this connection.(2)

Income taxation was resorted to by all nine federal governments to face their increasing expenditures. This was due to inevitable conflict. (1) Death taxes were

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(1) Sack, Alexander : "Double and Multiple Taxation; The Legal Phase of the Problem." in Current Problems in Public Finance. New York University Symposium, 1933. p.287.

(2) State Tax Commission of Utah v. Harkness. April, 1942.

## SECTION I.

### Overlapping and Experience.

Central-local tax grabbing assumes increasing proportions and portends serious friction. The central government is more and more entrenching upon the field traditionally reserved to subordinate units. In unitary countries, land and houses have been re-taxed on the central level (on net income) and other local sources are duplicated, such as indirect taxes. It is in federal countries that overlapping is most acute. At the early stage of federations, a clear demarcation line was drawn between federal sources, or indirect taxes, and local sources, or direct taxes. However, since the First World War, the federal governments have been encroaching upon local fiscal powers.

Income taxation was resorted to by all nine federal governments to face their increasing expenditures. This was conducive to ineluctable conflict.<sup>(1)</sup> Death taxes were introduced by six more federal governments, making seven in total. Much multiplicity arises from the co-existence of local and central death duties as in Argentina, the U.S.A., Canada and Australia. Clearly, <sup>less so</sup> this is ~~not the~~ case when the tax is

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(1) The extent of the conflict depends also on the nature of the local income taxing powers which may be unlimited as in the states in U.S.A., or definitely limited, as in the provinces in the Union of South Africa.

exclusively local as in Brazil and Switzerland, or exclusively federal as in Germany and the Union of South Africa, or when it is shared as in Mexico.

As for the property tax, three more federal governments invaded the field bringing the total to six. There is sometimes duplication as in Australia, Switzerland, Mexico and Argentina.

Federal governments seeped also into the general and specific sales taxes and gasoline taxes thus increasing the opportunities for confusion.

Various attempts were made to combat subsequent overlapping and chaos. World War II witnessed a great change in this connection as it exerted a centripetal effect.

The devices adopted differ in nature and degree of success. They feel the impact of historical development and central-local fiscal relations.

Separation of sources was applied in Brazil under the Constitution of 1937.

Tax sharing was adopted in Germany in 1919. Argentina in 1934 followed suit.

Australia was especially successful with the device of joint Federal-state administration before the Second World War.<sup>(1)</sup>

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(1) Whether the administration lied in the hands of the Federal government as with Western Australia, or lied in the hands of the constituent states. Complete centralisation took place in 1942 as will be seen later.



Some Canadian provinces agreed to the same compromise before 1941.

It is worthy of note that efforts towards central-local co-ordination met with quite a meagre success in a vast country like the U.S.A. comprising a great number of states fiscally potent.

We now give a few details on some countries.

There were no individual or corporate income taxes; no duties (apart from those used during emergencies, namely the Civil War and the Spanish-American War).

When the scope of taxation widened during the First World War, overlapping grew greater, horizontally and vertically. The exigencies of the Second World War intensified the situation. In fact, Corporate and personal income taxes constituted the main field of tax growth.

[1] "Current Problems in Public Finance," New York University. New York, 1943. See also: Federal, State and Local Taxation, 78th Congress, 1st Sess., Washington, 1943. p. 55.

## I. The United States.

Overlapping and duplicate taxation in the U.S.A. made their appearance after World War I. Prior to that war there was not much ground for tax confusion for two chief reasons:

- 1- The tax system on the Federal, state or local levels, was very simple.

- 2- Each layer of government had its well delineated taxes.

In fact, the main source of Federal revenue was the customs duties, and the states were not allowed to make use of them. The main source of state revenue was the general property tax which was protected from Federal encroachment by the Federal Constitution.

There were no individual or corporate income taxes, no death duties (apart from those used during emergencies, namely the Civil War and the Spanish-American War).

When the scope of taxation widened, during the First World War, overlapping grew greater, horizontally and vertically. The exigencies of the Second World War intensified the situation. In fact, Corporate and personal income taxes constituted the main field of tax grabbing.

- (1) "Current Problems in Public Finance." Symposium. New York University. New York 1933. p.276-286.  
See also:  
Federal, State and Local Government Fiscal Relations." 78th Congress, 1st Session. Senate Document No.69. Washington, 1943. p.57-62.

Corporate taxes were first applied on the federal level in 1909, and on the state level in 1911, Wisconsin being first. As for personal income taxation, Wisconsin was first in 1911. The other states, spurred by the federal example in 1913, followed suit. There was a first surge forward between 1911-1921 and another after 1928. The gasoline and motor-vehicle taxes were popular in the states between 1921-28.

At present, there is substantial overlapping in 10 taxes covering about 62 per cent of Federal, State and local tax collections. More precisely, the proportions, in 1941, were 88.4 per cent of Federal taxes and 75.4 per cent of state taxes. This is illustrated in the accompanying charts (PR 222) & 223)

On the municipal level, there is overlapping in the income taxes, tobacco taxes, corporation and business licences, motor-fuel taxes, motor-vehicle taxes and liquor taxes.

In the field of the property tax, there is no much state-local confusion as the tax is becoming more and more local. Besides, the assessment and collected <sup>are</sup> are integrated.

The amount of overlapping and duplicate taxation outpaces that of Canada.

FEDERAL, STATE AND LOCAL REVENUES FROM OVERLAPPING SOURCES

Fiscal Years ending in 1941. (1)

Tax	Revenue millions of dollars.			Per cent of Total Revenue in each Jurisdiction.			Per cent of Total Revenue from Each Source
	Total	Federal	State	Total	Federal	State	
Death and Gift	529	407	121	1	77.0	22.9	0.1
Corporation Income	2,242	2,053	190	2	91.5	8.4	.1
Individual Income	1,671	1,418	253	20	84.8	14.0	1.2
Tobacco	805	698	107		86.7	13.3	
Alcoholic Beverages	1,192	820	372	35	68.8	28.3	2.9
Motor-vehicle Licences	441		417	24		94.6	5.4
Motor fuel	1,264	343	914	7	27.1	72.2	.7
Stock Transfer	24	12	12		50.0	50.0	
Miscellaneous corporation	415	167	208	40	40.1	50.1	9.8
Pay roll	1,899	993	901	5	52.3	47.4	.3
Total Overlapping	10,485	6,911	3,440	134	65.9	32.8	1.3
Independent	6,501	907	1,122	4,472	13.9	17.3	68.8
Total Taxes	16,986	7,818	4,562	4,606	46.0	26.8	27.2
							38.3
							100.0

(1) "Federal, State and Local Government Fiscal Relations." 78th Congress, 1st session.  
Senate Document No. 69. Washington 1943. p. 59.



The Use of Overlapping Sources  
by States and Municipalities. (1)

State	Net Income Taxes		Death Taxes	Gift Taxes	Alcoholic Beverages		Motor-Vehicle License	Motor Fuel Taxes	Stock Transfer Taxes	Tobacco Taxes
	Corporation	Individual			Gallonege Taxes	Liquor Monopolies				
Number of States	32	33	47	12	31	17	48	48	6	39
					Total 48					
Extent of Municipal Overlapping	None	(a) Some	None	None	(b) Some		(c) Some	(d) Some	None	(e) Some

- (a) Philadelphia pioneered in 1940. Others followed. In 1950 personal income taxes, of one type or another, were levied in Louisville, St. Louis, Dayton, Springfield and many other cities in Pennsylvania. (2)
- (b) Generally as Licenses. Sometimes as excises, e.g. New Orleans.
- (c) Rather general in cities in Alabama, Arkansas, Illinois, North Carolina, Tennessee, Virginia.
- (d) In counties in Alabama, Mississippi and many cities in Florida, Nevada, Missouri.
- (e) Birmingham, Kansas City, St. Louis and many cities in Florida.

- (1) "Federal, State and Local Government Fiscal Relations." op.cit. p.59.
- (2) Snider, Clyde F. : "American State and Local Government." New York, 1950. p.578.

Plurality of Taxing government units in the U.S.A. :

Multiplicity and overlapping are inevitable in a country where there are thousands of taxing authorities.

The Taxing Units. (1)

The Nation		1
The States		48
Counties		3,050
Incorporated places (cities, villages etc.)		16,262
Towns and Townships		18,998
School districts		118,308
<u>Other Units</u>		
Water Control	2,911	
Irrigation and Conservation	712	
Rural Road and Bridge	1,688	
Urban Improvement	227	
Urban Utility	702	
Housing Authorities	525	
Social Conservation Districts	107	
Miscellaneous	1,510	
<u>Total</u>		<u>8,382</u>
Total Governmental Units		165,049

(1) Anderson, William : "The Units of Government in the United States." Public Administration Service. No.83 (Chicago 1942). p.2.



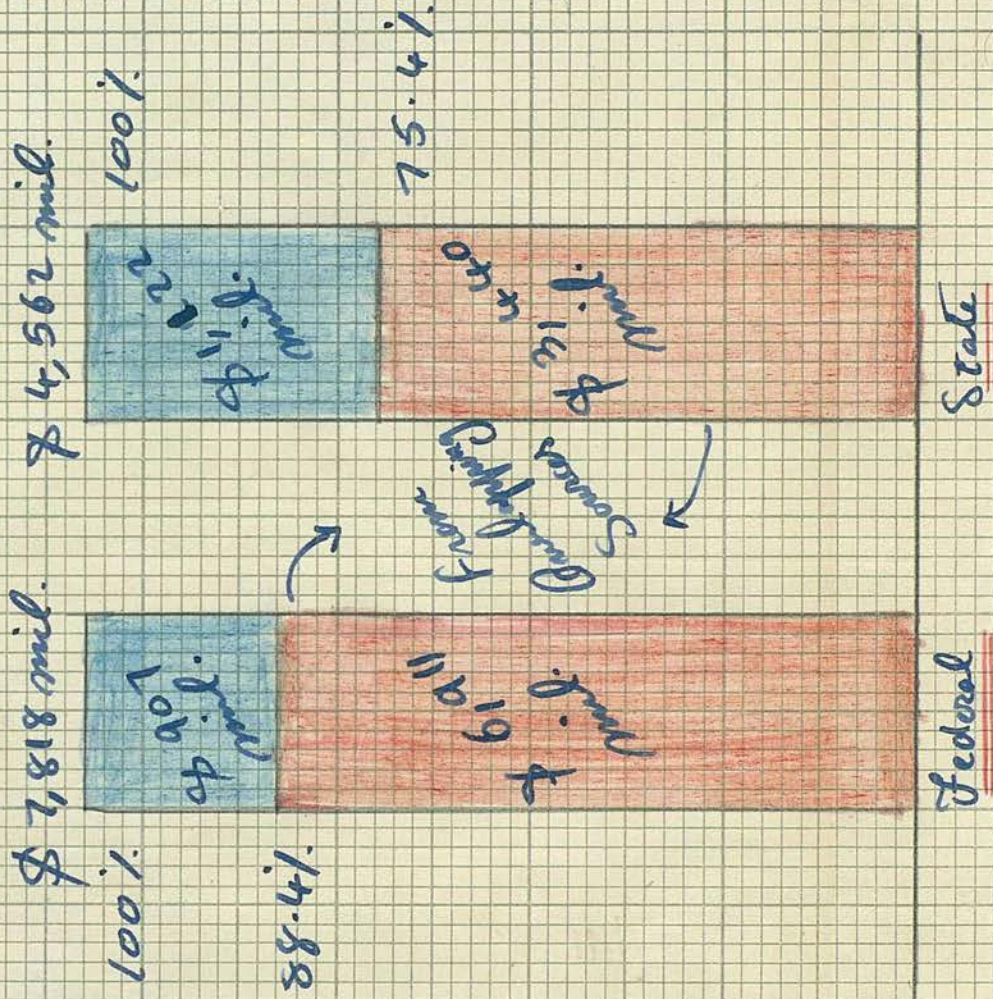
U. S. A.

# Percentage Of Federal And State

## Tax Revenues.

### Derived From Overlapping Sources. ①

Fiscal Years ending in 1941



① Federal, State and Local Government Fiscal Relations.  
Cm. cit. p. 60

PERCENTAGE OF FEDERAL AND STATE TAX REVENUES.

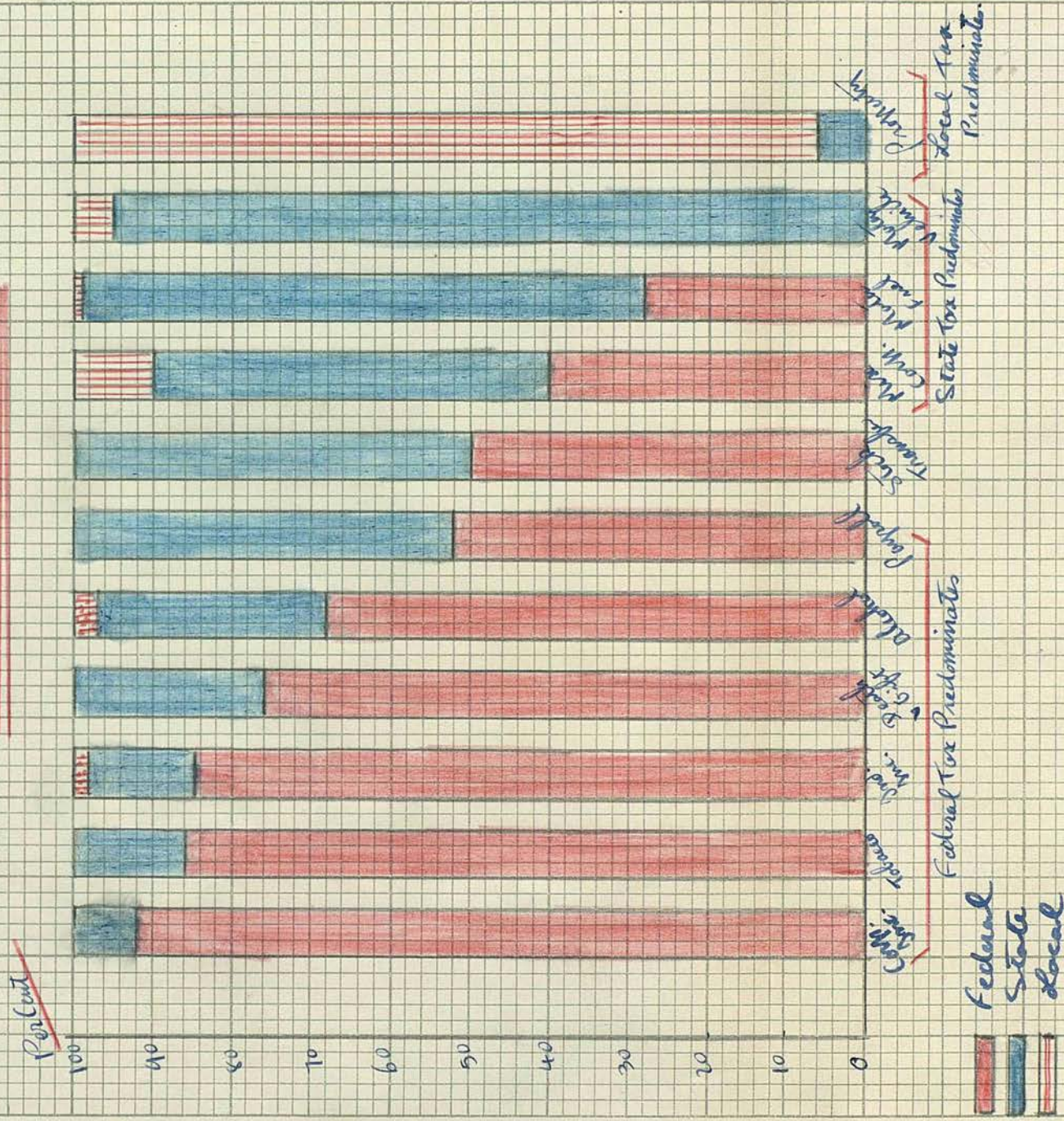
DERIVED FROM OVERLAPPING SOURCES. (1)

(Fiscal Years Ending in 1941)



# U. S. A. Extent Of Overlapping In Major Tax Sources. ①

Fiscal Years Ending in 1941



① Federal, State And Local Government Fiscal Relations,  
 Cm. cit P. 61



## II. CANADA.

There was little overlapping in Canada, before World War I. In fact, there was virtual separation between the fiscal sources of the Dominion and the subordinate governments. The British North America Act of 1867 specifically allotted direct levies to the provincial and municipal authorities and left the Dominion government with indirect levies. This was the normal pattern of apportionment since indirect taxation was the most lucrative.

Besides real-estate taxation, the provinces and municipalities slowly developed other forms of direct taxes such as, death taxes, corporation income taxes and personal income taxes. The first two were the most important.<sup>(1)</sup>

However, the pressure of expenditures induced the Dominion Government to entrench upon the field of direct taxation. There was a tax on gross receipts of certain classes of corporations in 1915. A war profits tax was levied in 1916. A personal income tax was introduced in 1918. By 1921, the Dominion Government was getting about one-third of its fiscal revenues from personal and corporate taxation.

It is worthy of note that the provinces in Canada were first in the field of corporate and personal income taxation; whilst in the U.S.A., the federal government and states were in

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(1) By 1913, one-fifth of provincial tax yields came from death taxes, corporate and personal income taxes.

competition nearly simultaneously.

The Canadian tax system developed steadily since World War I into a veritable hotch-potch of overlapping imposts by all tiers of government, federal, provincial municipal and other taxing bodies. There were personal income taxes in all provinces, provincial corporate taxes of no homogeneity. The death duties, combination of estate and succession duties, were imposed by all nine provinces and gave birth to much confusion and duplication.<sup>(1)</sup> In 1937 sales taxes were levied by two provinces and the municipalities of a third one. Motor-vehicle licences, gasoline taxes were in use in all provinces in 1937. There were taxes on real estate in both provincial and municipal governments.<sup>(2)</sup>

The Second World War caused an invasion of the Dominion Government. In 1941 it imposed inheritance and gasoline taxes. More important was the relinquishing by the provinces of personal and corporation income taxes for the period of the war, by virtue of Wartime Tax Agreements extending from 1941 to 1946 inclusive.

When in 1947 the agreements lapsed, a renewal was accepted

(1) The reciprocal agreements sometimes concluded between the provinces were rather formal and not effective. Moreover, they did not include the two wealthiest: Quebec and Ontario.

(2) Petrie, Richards : "The Taxation of Corporate Income in Canada." Toronto, 1952. p.7-10.

by seven of the nine provinces for a further period of five years.

From the standpoint of overlapping, the abstention of two important provinces (Quebec and Ontario) militated against homogeneity and orderliness. However, the postwar agreements eliminated multiplicity between the consenting territories in the field of personal income taxation and corporate income taxation. In the latter case, besides the Dominion tax, the provinces can levy an additional 5 per cent on profits (7% in Quebec and Ontario). These additions must however be imposed under a uniform act and must be administered by the Dominion Government which turns over the revenue to the provinces. Overlapping was also alleviated in the field of the succession duties, formerly a source of chaos. Here the Dominion Government allows a credit up to half its own duty. Quebec and Ontario are still, however in the field.

By the middle of 1951, there was no more overlapping in the personal income tax as it was confined to the Dominion Government and could no more be resorted to by any province or municipality.<sup>(1)</sup>

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(1) Perry, Harvey : "Taxation in Canada."  
Toronto, 1951. pp.28-34.



### III. AUSTRALIA.

Prior to 1910, the Commonwealth taxes and State taxes were virtually separate. Duplication and overlapping emerged when the Federal Government entered the field of land, income and inheritance taxation. Moreover, the local imposts on land and buildings (based on rental value) overlap with federal and state taxes.

Some figures may be given for illustration.

In 1912, nearly 80% of state tax revenues derived from income, inheritance and land taxes. In 1941, 70% of state taxes and 47% of federal taxes came from these three sources. The income tax is the main common fishing stream; it provides 58% of state tax revenue and 43% of federal tax revenue.<sup>(1)</sup>

However, overlapping in Australia never assumed the same complexity as in the U.S.A.

Early efforts were made to create homogeneity especially in income taxes, probate duties and land taxes. The attempts in 1916, 1918 and 1919 were not successful. In 1920, the administration of the taxes of Western Australia was operated by the central government. The latter also administered the taxes on inter-state incomes. More inter-state co-ordination was achieved in 1932.

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(1) Davis, Solomon Rufus : Federal-State Cooperation in Australia.  
Ph.D. (Econ.), London University, 1950. p.332.

The Second World War gave the Commonwealth Government the monopoly of the income tax. The states were allocated sums equal to their previous revenues therefrom.<sup>(1)</sup>

In 1946, the Australian Government was intent on pursuing the same policy of centralisation and the stated accepted. The replacement idea was superseded by an adjusted population basis considering both age distribution and density.<sup>(2)</sup>

The State Grants (Tax Reimbursement) Act, 1946 thus establishes uniform income taxation until 1957.<sup>(3)</sup>

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- (1) ".... it was not the need for reform as such but the more immediately pressing needs of war finance which actually brought about uniformity:-"

Laffer, K.M. : "Taxation Reform in Australia."  
Economic Record. Dec., 1942. p.172.

See also:

Bailey, K.H. : "The Uniform Income Tax Plan (1942)."  
Economic Record. Dec., 1944. pp.170-188.

- (2) See Part Three, Chapter VI, Section II.
- (3) "Taxing Powers in a Federation, A Study of Australian Experience."  
The Round Table. Sept., 1953. p.325.

## SECTION II.

### Local Property Taxation.

There is less room, in local property taxation, for overlapping or multiplicity in comparison to other taxes. Referring to the local real property tax, Mrs. Hicks says that; "it does avoid double taxation between local and other budgets so long as upper layers agree to vacate this tax, as they are usually prepared to do."<sup>(1)</sup>

There are, however, systems of local property taxation where duplication may arise. This is noticeable in the U.S.A. in real property and especially in personal intangible property.

Concerning real property, there ought to be no duplication as long as location, irrespective of the owner's residence, is taken as the basis for taxation and as long as the jurisdiction, within whose boundaries the owner resides, has no right to tax the latter's property if it lies in some other area.

In the past, however, real property was sometimes subject to taxation at the domicile of the owner, e.g. Texas until 1840.<sup>(2)</sup>

Furthermore, the ownership of real property may be divided; the life estate belonging to one party and the remainder to

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(1) Hicks, U.K. : "National and Local Finance." Economic Journal, 1946. p.619.

(2) Miller, E.T. : A Financial History of Texas. 1916. p.38.

to another. In this case, there are two different assessments and both tax liabilities are due to the area of location of real property.<sup>(1)</sup>

A further source of duplication, in the field of real property, stems from the assessment of property concerned with communications such as railroads. Railroad allocation is fraught with considerable difficulties. It is not easy to determine the importance of the local areas (states) where traffic begins or terminates and the importance of the "bridge" states. Traffic varies in intensity and the economic structure of the states within the country are dissimilar. The choice of a formula and the attempts to weight it is an intricate question. There are sundry formulas, e.g. the relative ton-and-passenger-miles, the relative all-track-miles, the relative gross revenues, the relative depreciated reproduction cost. Each state strives to make use of the most favourable formula. The outcome is that the assessment value sometimes exceeds 100 per cent and may reach 125 or even 150 per cent.

The same problems arise in connection with air-transportation which is inter-state by nature and where several formulas are available such as route miles, passenger miles flown and revenue miles flown.

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(1) Jensen, Jens P. : Property Taxation in the United States. p.106.



In the case of tangible personal property, some duplicate taxation is also to be noticed as in some states the rule of situs governs, while other states apply the principle of "mobilia personam sequuntur" or "personality follows the owner". The personal property of a non-resident owner could thus be taxed twice; once where it is situated and a second time by the state of domicile. Eventually evasion may ensue.

In the writer's view, tangible personal property, permanently located outside the state, should not be liable to taxation by the state of residence.

Much overlapping and multiple taxation occur in the case of intangible property in the U.S.A. Intangibles may be taxed at the owner's domicile (movables follow the person) and their place of location or the locality where they are used in business (i.e. business situs).<sup>(1)</sup>

Moreover, it is clear that the taxation of stocks and bonds, issued by corporations and representing physical property, involves double taxation.<sup>(2)</sup>

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(1) Groves, Harold : Financing Government. New York, 1945. p.61.

(2) Mills, Mark Carter and Starr, George W. : Readings in Public Finance and Taxation. New York, 1932. pp.430-438.

Jensen, Jens P. : "The General Property Tax, The Mainstay of Local Fiscal Autonomy."

The Annals of the American Academy of Political and Social Science. January, 1936. p.128.

The taxation of mortgages affords a further example of duplicate taxation. A farm with a property worth \$ 10,000 and burdened with a mortgage of \$ 5,000 pays the property tax on the whole value of the real estate and the holder of the mortgage pays tax on \$ 5,000.

The tax burden on the mortgaged farm is, therefore, heavier than the burden on a non-mortgaged farm as the former burden comprises the tax on the farm and the tax on the mortgage.<sup>(1)</sup>

Another problem, in the taxation of intangibles, is connected with evasion which is always possible, especially when some subordinate units of government do not tax intangible property or when the latter is subject to a relatively light burden.

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(1) Carl Shoup, Roy Blough, Mabel Newcomer:  
Facing the Tax Problem.  
Twentieth Century Fund. New York, 1937. p.299.

### SECTION III.

#### Local Personal Income Taxation.

The taxation of personal income, on the local level, bristles with technical difficulties and is fraught with important defects, notably overlapping.

Overlapping, or its counterpart evasion, springs from two chief sources:

- 1- The adoption, by the local taxing units, of dissimilar bases.
- 2- The varying interpretations attached, by the different local taxing units, to the same basis.
- 3- Other causes.

#### I. Origin, Residence and Overlapping.

In the taxation of personal income, the local unit disposes of different criteria. It can tax income according to location. In other words, it confines taxation to the sources of income within the locality to the exclusion of other sources of income outside the locality.

The local unit can also tax income according to residence. It thus taxes all income accruing to individuals staying in the locality, regardless of origin.<sup>(1)</sup>

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- (1) Maxwell, James A. : "The Fiscal Impact of Federalism in the United States." Cambridge, Massachusetts, 1946. pp.260-268.
- Groves, Harold : "Uniformity in State and Local Taxation" in Current Problems in Public Finance. New York, 1933. pp.276-286.
- Blakey, Roy and Johnson, Violet : "State Income Taxes." New York, 1942.

Other localities may attempt a combination of both principles and tax residents on total net income from whatever source and, in addition, tax non-residents on income accruing to them from sources within the locality.<sup>(1)</sup>

The subordinate units of government, whether states, provinces or regions are likely to be guided in their choice of basis by egoistic considerations. Most probably, poorer areas will prefer the principle of origin. This allows them to make full use of their domestic resources and takes into account the fact that the under-endowed areas are generally unattractive to wealthy residents.

If all local taxing jurisdictions apply the same basis, residence or situs, overlapping could be averted. However, the trouble arises when the various minor authorities adopt different principles in the same time. The lack of inter-local uniformity in this connection is a serious source of multiple taxation or alternatively evasion.<sup>(2)</sup>

Suppose an income-receiver residing in locality A, has property and other flows of income in locality B. Such person will be taxed twice if the bases adopted are residence and origin respectively. If the positions are reversed and the

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(1) Vickrey, William : Agenda for Progressive Taxation. New York, 1947.

(2) Girard, Richard : The Scope for Uniformity in State Tax Systems. State Tax Commission, Report No.8. New York, 1935 passim.



income-receiver resides in locality B, and owns property in A, he escapes taxation altogether.

Similarly, the taxation, by the same locality, of residents on all individual income and in addition non-residents on income within the locality, is conducive to duplicate taxation whether the other taxing jurisdictions resort to the same practice or tax only according to residence or only according to situs.

On the other hand, if some localities are income-taxing and others are non-taxing, cases of exemption manifest themselves. When a locality taxes only residents on all income but not the non-residents on local income, the latter will be exempt if their home locality does not impose any tax. The non-residents will consequently enjoy privileged treatment vis-a-vis the residents within the taxing locality.

Similarly, if the taxing locality lays the tax on the basis of situs only and if some local residents own property or earn income in the non-taxing locality, they will be exempt and consequently are put at an advantage vis-a-vis the residents of the taxing locality whose property or income originate inside the taxing jurisdiction.

(1) Groves, Harold : Financing Government.  
New York, 1945. p.203.

(2) Shaw, Irving L. : Domicile as the Criterion of Liability  
to Personal Income Taxation.  
National Tax Association, Proceedings, 1930. p.314.

## II. Residence, Domicile and Overlapping.

The non-uniformity in the interpretation of some concepts is a further source of confusion and intermingling. The income-taxing local units may hold diverse views on the conditions of residence and domicile.<sup>(1)</sup>

Some localities may identify residence with domicile. Some may include domiciliaries among residents. Some others may distinguish between domiciled and residents. An income-receiver may pay taxes to two localities, both taxing residents on total net income because each adopts a different set of alternative definitions of residence.

The controversial character of this knotty problem has important implications from the fiscal standpoint. It does not only militate against a fair distribution of the tax burden but it can also adversely affect tax revenues since the questions of domicile and residence are of especial importance with regard to high-income receivers more than with low-income receivers.<sup>(2)</sup>

The local taxing jurisdiction may choose domicile. Domicile is not easily subject to statutory definition. It is

(1) Groves, Harold : Financing Government.  
New York, 1945. p.208.

(2) Shaw, Irving L. : Domicile as the Criterion of Liability to Personal Income Taxation.  
National Tax Association, Proceedings, 1920. p.314.

a common law concept. Moreover, domicile depends to a great extent on one's intentions and it is possible to allege domicile elsewhere especially for the purpose of evasion. Local domiciliaries, residing elsewhere, cannot be easily submitted to taxation.

In the writer's view, an important demerit of domicile is that it is conducive to unsound and arbitrary results. To tax the total net income of a person who was not within the boundaries of the locality during the year (or for several years) simply because he is domiciled therein, and to exempt a person actually residing in the subordinate unit, enjoying its protection and services for the simple reason that he has not the intention of making his home there indefinitely (or did not abandon his previous home) does not sound logical at all.<sup>(1)</sup>

In order to cope with this incongruity and other flaws, it seems preferable to adopt residence as a basis for local income taxation. Residence will have to be defined as remaining within the local unit for a specified period of time during the taxable year, for example six or seven months. It will thus be possible to tax all persons within the local boundaries regardless of their intentions concerning the

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(1) Keesling, Frank M. : The Problem of Residence in State Taxation of Income.  
California Law Review. September, 1941. p.720.

duration of their stay. It is necessary to uniformise and generalise the principle in all local taxing jurisdictions.

However, there are still difficulties which indicate the inherent intricate character of the problem of local income taxation. The resident may not pass the prescribed period within the subordinate unit, whether intentionally or not, and so may escape taxation altogether. Inter-personal fiscal inequity arises from the fact that two local residents, having the same income are not equally treated although they may have passed the same lapse of time in the same area: one is taxed because his period lies within the taxable year whilst the other is untaxed because his period falls partly in one taxable year and partly in the succeeding one. Loss of revenue may be also caused to the local taxing jurisdiction through frequent change of residence. It is true that, eventually (in difficult cases), a presumption of residence could be taken as being the maintenance of a permanent place of abode within the locality, or its maintenance for a specified period during the taxable year. However, a person may maintain different places of abode in several localities and thus become subject to duplicate taxation.

In any case, it is to be mentioned that what is needed to avert overlapping and multiple taxation is just the universal adoption, by all underlying authorities, of the one and the same principle of taxation, either residence or situs.<sup>(1)</sup>

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(1) For our suggestions see Part Three, Chapter V, Section I.



To sum up, these considerations reveal the complexities underlying local income taxation and makes necessary the recourse to some fundamental reforms. Inter-local tax credits are advisable in case both residence and situs are used concomitantly by diverse localities or simultaneously by the same locality. The problems which inhere in the credits are expounded below. More drastic reforms are advocated such as the central-local sharing of centralised income taxation or at least the centralisation or federalisation of the administration and collection of the locally levied income taxes whether the latter affect the form of independent levies, or tax supplements on the central tax.

However, this is the subject-matter of the two last chapters.<sup>(1)</sup>

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(1) See Part Three: "Intergovernmental Fiscal Coordination."

Reed, Clarence E. "Residency: A Critical Appraisal of Its Possibilities," National Tax Association, Proceedings, 1940, p. 350.

### III. Inter-Local Credits and Overlapping.

If the bases of residence and situs are applied simultaneously by different local units within the same country or by the same local unit, it is possible to avert multiple taxation thanks to the provision of inter-local tax credits.

However, the problem is complex and account must be taken of the basis of taxation applied (residence, situs or both), the type of credit provided for (resident credits or non-resident credits) and the nature of the credit (conditional or unconditional, unilateral or reciprocal). If multiple taxation in some cases can be coped with, it is, in other cases, still present or, eventually, the taxpayer may enjoy total exemption.

In case some localities adopt residence and others situs, duplicate taxation can be averted as long as all the local units without exception agree to granting the one and the same type of credit, i.e. either resident credits or non-resident credits. It is thus immaterial whether the locality of residence provides credits for taxes paid to other localities on "extra-territorial" income or the locality of non-residence gives credits for taxes paid to the locality of residence on

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- (1) Credits to non-residents will generally be on a reciprocal basis. It is noteworthy that such credits, if widely adopted, lead to sacrifice of situs to the advantage of residence. The unconditional credits to residents favour situs. See:  
Heer, Clarence : "Reciprocity, A Critical Appraisal of Its Possibilities," National Tax Association, Proceedings. 1940. p.350.

income earned in the non-resident locality. The important thing lies in the universal adoption of either principle.

If both resident credits and non-resident credits are used simultaneously by different localities within the same country, there will be either duplicate taxation or complete evasion. Indeed, if some localities grant residents a credit for taxes imposed by other jurisdictions and some provide for non-resident credits to compensate for taxes paid to the locality of residence, residents of the latter who derive income from the former will not obtain credits in any locality. On the other hand, if some local units allow residents a credit for taxes levied by other localities and some allow non-residents a credit for taxes imposed by the locality of residence, residents of the former, to whom accrues extra-territorial income from the latter, will be in a position to escape local taxation altogether. <sup>(1)</sup>

If both resident and non-resident credits are used simultaneously by the same local unit, two credits may be claimed by the same person and total exemption ensues.

In the latter case, and in general, it seems appropriate that the local unit uses a bilateral credit system in which resident and non-resident credits are applied, discriminately

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(1) It is noteworthy that the universal and unconditional provision of credits to residents, when all localities adopt residence, is conducive ultimately to the taxation on the basis of situs without its concomitant of income partition or the divisibility of ability to pay.

according to the attitude of the other taxing jurisdiction. In other words, the credit to residents would be confined to taxes imposed by other localities which do not allow credit to non-residents. This relieves the residents from duplicate taxation and the incongruity of both localities of residence and non-residence providing for credits to the same person is eliminated.

On the other hand, non-residents would be denied credits for taxes imposed by the locality of residence if the locality of residence of the non-residents allows an unconditional credit to its residents.<sup>(1)</sup>

It is clear that non-residents would be subject to multiplicity if their locality of residence taxes income of residents from outside sources and in addition taxes income of non-residents from local sources but does not grant credit to either residents or non-residents.<sup>(2)</sup>

It ought to be mentioned that even if the various local units, taxing according to residence and situs, agree on the universal application of one type of credit, i.e. either resident or non-resident credits, there may still persist some partial duplicate burden not only because the tax paid to the

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(1) See our suggestions concerning inter-local credits in the Epilogue or Part Three, "Intergovernmental Fiscal Co-ordination."

(2) The Interstate Commission on Conflicting Taxation. 1935 Progress Report, "Conflicting Taxation." Chicago, 1935.



locality of residence is likely to be higher than the tax due to the locality of situs, notably in the case of local progressive taxation, but also on account of the possible inter-local tax differentials (caused by tax provisions and rate schedules) exhibited by the different local units.

This mode of local taxation, especially if the subordinate units are small and the country as a whole is highly industrialized.

The only acceptable cases may be the new federations formed of more or less agricultural areas with little income qualifications such as the Central African Federation, Pakistan, Libya or the proposed British Caribbean Federation or the East African Federation. Some particular types of federations are most amenable to regional income taxation. We have in mind the proposed four-tier federation of Pakistan intercalating one further layer, namely the western and eastern regions.

Highly industrially developed countries like the U.S.A. usually suffer, to an appreciable extent from the same anomalies already briefly diagnosed. Indeed, we may, in application, dissimilar bases in state income taxation. Wisconsin adopts situs, Delaware adopts domicile, the State of New York combines both as it taxes residents on all income and non-residents on income derived from sources within the state. The heterogeneity of interpretation of domicile and situs

#### IV. Inter-Local Overlapping and Experience.

The problems outlined above are a pointer to the intricacies and difficulties involved in income taxation, of persons or business, on the local level, whether in unitary or federal countries. The inequities ushered in are a deterrent to this mode of local taxation, especially if the subordinate units are small and the country as a whole is highly industrialised.

The only acceptable cases may be the new federations formed of more or less agricultural areas with little income ramifications such as the Central African Federation, Pakistan, Lybia or the proposed British Caribbean Federation and the East African Federation. Some particular types of federations are most amenable to regional income taxation. We have in mind the proposed four-tier federation of Pakistan intercalating one further layer, namely the western and eastern regions.

Highly industrially developed countries like the U.S.A. actually suffer, to an appreciable extent, from the same maladies already briefly diagnosed. Indeed, we see, in application, dissimilar bases in state income taxation. Wisconsin adopts situs, Delaware adopts residence, the state of New York combines both as it taxes residents on all income and non-residents on income derived from sources within the state. The heterogeneity of interpretation of residence and domicile

is also present between non-situs states. California does not tax a domiciliary if he has a residence elsewhere. New York exempts domiciliaries who maintain no permanent place of abode in the state. However, Delaware and Louisiana interpret domicile merely as being citizen of the state.

As concerns the inter-area tax credits intended to cope with overlapping, non-uniformity of practice unfortunately exists in the U.S.A. in inter-state relations. The desired objective is thus often not reached. In fact, some states (about five) allow credits to non-residents; instances being provided by Iowa, New York, North Carolina, South Carolina and West Virginia. Some other states grant credits to residents i.e. Colorado, Georgia, Kansas, Mississippi and Vermont. Other states (about six) provide for credits to both residents and non-residents; Alabama, California, Kentucky, Maryland, New Mexico, Virginia.

Last, but by no means least, the problems of overlapping connected with local income taxation, are the more accentuated the smaller the taxing areas. If, besides regions, provinces or states, the municipalities enter the field, spurred by financial need, we shall be grappling with further complications.

Before World War II, many municipalities in Canada, especially in the Maritime Provinces, used to collect exemption and their rates are low and uniform rather than graduated (they range from 1/5 of 1% to 1%, but, who knows? they may increase in future). See: Miller, Clyde : "What can Cities Tax Next?" in National Municipal Review, May 1949, pp. 31-318, and "American States and Local Government". New York, 1950. pp. 78.

considerable amounts in income taxes.<sup>(1)</sup> These were relinquished to the Dominion Government during the war.

However, in the U.S.A., there is a clear and unfortunate tendency, since 1940, toward municipal income taxation. Both geographical and coverage extensions are noticeable.

Philadelphia pioneered in 1940. Toledo followed suit, as well as many other cities such as St. Louis, Louisville, the Ohio cities of Columbus and more than 40 cities and boroughs in Pennsylvania.<sup>(2)</sup> While the Philadelphia tax covered only

salaries, wages and net profits of unincorporated businesses and professions, the Toledo tax extended to corporate profits as well.<sup>(3)</sup> (All local personal income taxes yielded 44 millions in 1948).

The dual trend of municipal income taxation, whether in the U.S.A. or elsewhere, portends serious obstruction of tax justice.

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- (1) Brittain, Horace : "Local Government in Canada." Toronto, 1951. p.97.  
Curtis, C.A. : "Municipal Finance and Provincial Federal Relations." The Canadian Journal of Economics and Political Science. August, 1951. p.297.
- (2) Beck, Morris : "The Philadelphia Income Tax: A Solution to Municipal Financial Difficulties." in Bulletin of National Tax Association. Dec. 1947.
- (3) The differences between municipal and state income taxation in U.S.A. are that the former allows no personal exemption and their rates are low and uniform rather than graduated (they range from 1/5 of 1% to 1%, but, who knows? they may increase in future). See:-  
Snider, Clyde : "What can Cities Tax Next?" in National Municipal Review, May 1949. pp.212-218, and  
 "American State and Local Government." New York, 1950. p.578.



U.S.A.     The Diversity of State Individual Income Taxes,  
Examples (December, 1949)     (1)

State	Exemptions S: single M: married couple D: dependent	Rate or Rates	Status of Federal Income Tax
Alabama	S: \$1,500 M: 3,000 D: 300	Graduated: 1- $\frac{1}{2}$ per cent on first \$1,000 to 5 per cent on excess over \$5,000.	Deductible
California	S: \$2,000 M: 3,500 D: 400	Graduated: 1 per cent on first \$10,000 to 6 per cent on excess over \$30,000.	Not deductible
New York	S: \$1,000 M: 2,500 D: 400	Graduated: 2 per cent on first \$1,000 to 7 per cent on excess over \$9,000. A tax credit of 10 per cent is currently applicable.	Not deductible
Wisconsin	Tax Credit: S: \$ 8.00 M: 17.50 D: 4.00	Graduated: 1 per cent on first \$1,000 to 7 per cent on excess over \$12,000. Teachers' retirement surtax of 16.2/3 per cent of the normal tax less \$37.50. Additional surtax of 25 per cent of computed tax.	Deductible to extent of 3% of net income before deductions and for donations federal income taxes.

- (1) Kimmel, Lewis H. : Taxes and Economic Incentives.  
 Washington, 1950. p.204-205.

## SECTION IV.

### Local Business Taxation.

In modern economic conditions of industrial expansion and business integration, the ramifications of manufacturing or mercantile concerns stretch all over diverse localities within the same country. An enterprise may be located in an area, buy raw materials in another, stock them in a third, manufacture them in a fourth and sell the final products in a fifth area. A given stage may even be amenable to further splitting. Sales may be contracted in a local unit and actually delivered in another.

On the local level, business may be subject to taxation in two ways; taxation according to some indices or taxation on net income. Both cases usher in varying amounts of overlapping and multiplicity.

In the case of specific taxes, the same indices may serve to lay several taxes under different guises. As for net corporate income, it is a sound basis for business taxation on the central level. However, when transplanted to the local level, it degenerates into a source of substantial overlapping whether the local units adopt the "origin tax" pattern or the "residence tax" pattern, as will be expounded in due course.

In the field of local business taxation, duplicate taxation affects two forms; "that by competing jurisdictions or

authorities, and that by the same jurisdiction or authority."<sup>(1)</sup>  
 Clearly the more the lower tiers of government and the wider  
 their fiscal powers, the more the confusion and intermingling.

### I. Taxes On Other Than Net Income.

The underlying units of governments, especially in a  
 federal polity, have enough latitude to impose a variety of  
 taxes on some rough measure of the volume of business.  
 Sundry criteria are available such as the capital stock,  
 hereditaments, payroll, costs of production, volume of output,  
 volume of sales, gross receipts. The trouble is that the  
 indices may be used more than once, totally, partially or in  
 different combinations by the same taxing authority or by  
 competing taxing authorities. Moreover, there may be great  
 variations in the application of local taxes of the same type.

It is deemed necessary to refer to some specific instances  
 to allow a clearer appreciation of the problem. Let us take the  
 U.S.A. where the states, especially in the south, make an  
 extensive use of specific business taxes,

There are the arbitrary "occupation taxes" of  
 multifarious types of which about 150 exist in Alabama alone.  
 These imposts are assessed on items already subject to taxation

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(1) Seligman, Edwin R.A. : Essays in Taxation. New York,  
 1928. p.98.

of some form or another (either local net corporate income taxes or other local specific taxes). These items cover a wide range; premises, kind or size of equipment, volume of actual production, kind or size of products and so on.<sup>(1)</sup> There are also many Severance Taxes based on the volume or value of natural products severed from the ground, e.g. coal, oil,

The taxation of business physical property and intangibles evidently involves duplication. Taxes on gross receipts also lead to the same results.

The "capital stock tax" levied by about two-thirds of the American states, is a cause of much duplication. The tax is imposed on corporations for the privilege of engaging in business in a corporate capacity. They are based either on the market value of the stock or on the par value of securities issued or authorised. The states have the legal right to tax all securities issued by the business they incorporate.<sup>(2)</sup>

The overlapping assumes important proportions when the states levy also "corporate excess taxes" on the difference

(1) Hansen, Alvin and Perloff, Harvey : State and Local Finance in the National Economy. New York, 1944. p.45.

(2) Some states, e.g. Michigan, tax only the portion of capital stock employed within their boundaries. In fact, capital stock alone is not an accurate picture of the capital of the corporation. There are the bonds and other indebtedness.



between the capital value of the corporations as measured by par or market value of their capital stock (and sometimes bonds) and the actual or assessed value of their real and personal property.<sup>(1)</sup>

In spite of the great variety of the specific business taxes they accounted for only about 11 per cent of total state tax revenue. "Their yield certainly does not justify their troublesomeness and the high compliance costs they entail."<sup>(2)</sup>

## II. Taxes on Net Income.

The core of the problem in this field lies in the existence of inter-area business income. Tax grabbing may induce the local units to tax the entire net income of the "domestic" concerns, regardless of jurisdictional source. This naturally results in serious multiplicity as the other local units are also entitled to tax flows of income originating within their sphere.

The undesirable consequences inherent in the taxation of inter-local corporate income can be obviated by confining the local tax to income accruing within the taxing unit alone. In

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(1) Federal, State and Local Government Fiscal Relations. 78th Congress, 1st Session - Senate Document No.69. Washington, 1943. p.455.

(2) Hansen and Perloff : op.cit. p.46.

other terms, if cosmopolitan corporate income could be apportioned adequately between the various localities horizontal overlapping would be averted.

Various devices for apportionment are open to the taxing localities. The main point is to have one universal device. The criterion chosen must be also homogeneous and not diversely interpreted, otherwise overlapping will still persist.

We may now review the various devices.

#### **Separate Accounting:**

From the fiscal equity viewpoint this is probably the most desirable device. However, it is beset with difficulties.

In "separate accounting", the local concerns keep their accounts so as to show the amount of profit realised in each local subdivision. In other words, the local branch of an enterprise is considered as a separate accounting unit.<sup>(1)</sup>

However, the difficulties are numerous. From the theoretical point of view, the method is not consistent with economic unity. Indeed, it is hardly conceivable to segregate the various interdependent or complementary processes of an enterprise or to consider that a profit has been realised at any particular stage.

From the point of view of practicability, an important

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(1) Carroll, M.B. : "General Survey of Allocation Methods," Taxation of Foreign and National Enterprises. League of Nations, Geneva, 1932.

problem arises from the necessity to price the goods transferred from the concern to a subsidiary or associated one. Professor T.S. Adams believes in the possibility of building up factory prices in case they do not exist and finds the method of separate accounting superior to others.

However, the underlying problems are intricate. The appropriate invoice price is not easy to ascertain. The output of the manufacturing concern may not be all sold to the trading affiliate at the same price or yield the same rate of profit. A comparison between the concern and other similar ones lacks accuracy. Many expenses and receipts, such as overhead, will require some form of pro-rating allocation. Moreover, the billing price to a branch may be made so high as to restrict the profits of the branch. The various charges (interest, services, etc.) may be also subject to varying methods of calculation.

It is important to point out with Professor Hatfield that, "It is impossible to frame a system of cost accounting applicable to establishments of different character."<sup>(1)</sup> The technical knowledge involved, especially in the case of highly integrated concerns may be lacking in the tax commissioners, especially on the local level. The expenses caused either to

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(1) Hatfield, H.R. : "Accounting, Its Principles and Problems" New York, 1928. p.397 and after.

business or to the authorities are a further handicap.

In short, "the testimony of experienced accountants is that a system of separate accounts for branches or subsidiaries is, in the majority of cases, impracticable."<sup>(1)</sup>

In these conditions, it is necessary to search for some other alternative, <sup>solution</sup> to inter-local business income.

#### Ratio of Local to Total Expenses:

Some propose to proceed to the allocation of inter-local corporate income on the basis of the ratio of expenses incurred by the concern within the local unit to total expenses. An important concomitant of the method consists in the reduction of fixed capital investment to equivalent annual charges.

The advantage of this device over separate accounting is that it complies with the sound concept that a business is a single unit. If it has, as a whole, realised a profit, the various local units where the subsidiaries are located will be entitled to tax these branches even if any particular one does not show a profit. The tax will thus be based on a pro rata share of total net income defined by the proportion of local annual expenditures of the concern to its total expenditures. Conversely, if the business, as a whole, suffers a loss, no

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(1) Report of the Committee on Uniformity and Reciprocity in State Tax Legislation.  
National Tax Association, Proceedings, 1931. p.306.



locality will be able to tax any branch even if it is remunerative.<sup>(1)</sup>

In the writer's opinion, this method is, however, open to criticism on two main grounds. From the practical point of view a local unit will not easily consent to leave untaxed a branch which has produced profits. It may be argued, on the other hand, that a locality is empowered to tax an unprofitable concern. However, as there is little connection between the ratio of local to total expenses and taxpaying capacity, the locality may be reluctant to inflict any harm on unprofitable local business for fear of depleting a source of revenue.

Furthermore, the method is discriminatory and dis-equalizing between well-off and under-privileged areas. Local expenses are variable. Sometimes they are high as in manufacturing. Sometimes they are low or too small to give any substantial yield as in the case of sales.

Different accounting problems are also noticeable. The translation of capital investment into equivalent annual expenses raises the question of property valuation with all its intricacies (which basis: original cost? reproduction cost: prudent investment? ...)

To sum up, the device discussed does not seem to be a satisfactory or workable one for the local units to use.

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(1) Howard, M.S. : "Elimination of Double Taxation of Corporate Net Income." The National Tax Magazine, Sept. 1930. pp.329-331.

### Allocation Fractions:

The local business taxing units can proceed to the allocation of inter-local income in some rough way instead of assigning business income item by item to the locality. A criterion for allocation is thus adopted. The allocation fraction or formula may be composed of an element or several elements according to the views of the locality on the proper criterium and according to the dominant character of local business.<sup>(1)</sup>

One may mention a wide range of formulas in which not only elements change but also the weighting used. A few instances can be given.<sup>(2)</sup>

S = the sales or gross receipts ratio.

T = the value of tangible property ratio.

C = the cost of manufacturing, mining or selling ratio.

P = purchases ratio.

R = payroll ratio.

CS = Costs of sales ratio.

G = accounts receivable, bills for sales or services rendered.

H = stock of other corporations.

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(1) Blakey, Roy and Johnson, Violet : "State Income Taxes".  
New York, 1942. p.59-71.

Adams, T.S. : "Allocation versus Apportionment."  
National Tax Association, Proceedings, 1931. p.346.

(2) See Chapter One: Section III "Fiscal Equity and Local Business Taxation."

The formulas may or may not be weighted. Here are some weighted formulas which a local unit can adopt:

$$\frac{S + T + CS}{3}$$

$$\frac{S + T + C}{3}$$

$$\frac{S + C}{2}$$

$$\frac{S + T + R}{3}$$

$$\frac{S + T}{2}$$

$$\frac{T + R + CS}{3}$$

$$\frac{T + R + CS}{3}$$

$$\frac{T + G + H}{3}$$

$$\frac{R + P + S}{3}$$

$$15\% T + 15\% R + 70\% S. (1)$$

The method of apportionment formulas has many advantages. It is simple, flexible and, from the administrative point of view, economical and efficient.

However, certain defects and sources of overlapping are noticeable. They may be outlined here.

1- The structure of the allocation formulas: Choosing an allocation formula is not an easy thing for the local taxing unit to do. Does the situs of taxable income coincide with physical property or sales or costs or payroll? How to proceed to weighting? What relative importance to give to manufacturing or warehousing or distributing? Should the non-business income of the corporation for instance from intangibles be considered part of total net income for the purpose of applying the allocation fraction?

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(1) Blakey and Johnson. : op.cit. Supplement to p.66

Whether the allocation fraction is composed of one element or more it is essentially arbitrary since it is founded on some approximation of taxpaying capacity and not on an accurate computation of local income. If the ratio of local physical assets to total assets is adopted, the business may be subject to local taxation while it did not realise any profit within the taxing jurisdiction.

A further source of trouble stems from the fact that the components of the allocation fraction do not adequately respond to the multifarious types of businesses carried out within the boundaries of the local unit. If a formula based on real property or costs suits manufacturing, it does not suit trading.

The local taxing authority is thus faced with two possibilities which both lead to overlapping and multiplicity. It may try to widen the basis of the formula by combining a certain number of elements and thus open the door to more confusion. It may prefer to devise two or more allocation formulas for the use of the different local businesses or leave to local business itself the option between alternative formulas. This might work injustice against local business in the way expounded in next point.

2- Heterogeneity in local allocation formulas: In the writer's view the chief source of confusion and overlapping arises from the adoption, on the local level, of dissimilar allocation fractions. The local units, professing different views on local



taxpaying capacity, can put a repressive burden on business and tax it at more than 100 per cent of its total income.<sup>(1)</sup>

This result occurs whether the local unit uses a single fraction or a dual fraction, of the simple type or of the composite type.

Let us consider first the case of the single fraction. Locality A bases the fraction on real property. Locality B bases it on sales. A concern located in A will be taxed there on the assumption that property is the pointer to its income. The same concern, transacting the greatest part of its sales in B, is liable to tax there on the assumption that sales, and not property, are the measure of its income.

If a business operates in two local units, which each applies the dual fraction system (for instance each having a fraction for manufacturing besides another for trading), there will clearly be overlapping, even if both couples of formulas are similar in the two localities, since the concern may be dealing with manufacturing in an area and distributing trade in another.

We can illustrate these facts with reference to the U.S.A. The business-income taxing states use about twelve basic allocation fractions. Weighting ranges from zero to 100 per cent. The variety of formulas is thus wide especially that

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(1) See Part One, Chapter I: Section III "Local Business Taxation."

different interpretations can be attached to the components of the formulas. A corporation claimed to be subject to 30 formulas. <sup>(1)</sup>

	Property	Gross Receipts	Allocation Factors	Approximate Percentage of Taxable Income.
Connecticut	\$5,000,000	\$1,000,000	Property	83.33
Tennessee	1,000,000	4,000,000	Gross Receipts	80.0
	<u>\$6,000,000</u>	<u>\$5,000,000</u>		<u>163.33</u>

Example No. II

	Property	Payroll	Gross Receipts	Allocation Factors	Approximate Percentage of Taxable Income.
Utah	\$6,000,000	\$3,000,000	\$1,000,000	Property	62.5
Missouri	2,000,000	1,000,000	3,000,000	Payroll	55.5
Illinois	1,000,000	1,000,000	3,000,000	Gross Receipts	33.5
	<u>\$9,000,000</u>	<u>\$5,000,000</u>	<u>\$7,000,000</u>		<u>151.5</u>

<sup>(1)</sup> Ford, Robert S. : "The Allocation of Corporate Income for the Purpose of State Taxation." State Tax Commission, Report No.6. New York, 1933. p.93 and p.100-106.

Duplicate Taxation Resulting From The Application  
of Varying Formulas. (1)

Example No. I

State	Property	Gross Receipts	Allocation Factors	Approximate Percentage of Taxable Income.
Connecticut	\$5,000,000	\$1,000,000	Property	83.33
Tennessee	1,000,000	4,000,000	Gross Receipts	80.0
	<u>\$6,000,000</u>	<u>\$5,000,000</u>		<u>163.33</u>

Example No. II

	Property	Payroll	Gross Receipts	Allocation Factors	Approximate Percentage of Taxable Income.
Connecticut	\$5,000,000	\$3,000,000	\$1,000,000	Property	62.5
Assets	2,000,000	1,000,000	5,000,000	Payroll	33.5
See	1,000,000	1,000,000	3,000,000	Gross Receipts	33.5
	<u>\$8,000,000</u>	<u>\$5,000,000</u>	<u>\$9,000,000</u>		<u>129.5</u>

(1) Ford, Robert : op.cit. p.103. The examples are of informative value.

# Advantages of the Uniformity in Application of a Formula. (1)

## 1- The Tennessee Formula: Gross Receipts.

State	Property	Payroll	Gross Receipts	Percentage of Taxable Income.
Connecticut	\$5,000,000	\$3,000,000	\$1,000,000	11.11
Massachusetts	2,000,000	1,000,000	5,000,000	55.55
Tennessee	1,000,000	1,000,000	3,000,000	33.33
	<u>\$8,000,000</u>	<u>\$5,000,000</u>	<u>\$9,000,000</u>	<u>99.99</u>

## 2- The Massachusetts Formula: Property, Payroll and Gross Receipts

State	Property	Payroll	Gross Receipts	Percentage of Taxable Income
Connecticut	\$5,000,000	\$3,000,000	\$1,000,000	44.54
Massachusetts	2,000,000	1,000,000	5,000,000	33.52
Tennessee	1,000,000	1,000,000	3,000,000	21.94
	<u>\$8,000,000</u>	<u>\$5,000,000</u>	<u>\$9,000,000</u>	<u>100.00</u>

(1) Ford, Robert : op. cit. p.103. The examples are of informative value.



In support of our contention that a uniform method for income apportionment is most desirable, we may quote the Committee of the National Tax Association:

"From the standpoint of the taxpayer, uniformity between states is by all odds the most essential requisite. It might make little difference to the taxpayer whether he is taxed on seventy-five per cent of his income at the place of manufacture and twenty-five per cent at the place of sale, or vice versa, so long as he is taxed only on one hundred per cent altogether. The fairest apportionment rule conceivable would be of little help to the taxpayer if only one state adopted it and the others continued to use a different rule.<sup>(1)</sup>

As already pointed out, the Massachusetts formula has been recommended for general use in the U.S.A. especially by a committee of the National Tax Association.<sup>(1)</sup> The formula runs as follows:

Average value of tangible property + within state	Payroll within state	Gross Receipts within state	÷ 3
Average value of total tangible property	Total Payroll	Total Gross Receipts	

Uniformity in the use of one formula would hold taxable

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(1) Report on "Uniformity and Reciprocity in State Taxing Legislation." 1933.  
For a general discussion of this formula see:  
Blakey and Johnson : op.cit. p.65-76.

income to 100 per cent. However, even in this case there may still be ground for overlapping as explained in next point.

### 3- Conflicting Interpretations of Allocation Fractions:

Some components of a given allocation fraction may be susceptible of different interpretations and thus open the door to varying definitions which ultimately generate overlapping even between the localities which apply the same formula.

Certain elements are particularly indefinite in this connection such as sales. Sales can be taxed in:

- a- the locality to which payment is made.
- b- the locality from which the commodity is shipped.
- c- the locality to which the commodity sold is shipped.
- d- the locality where the order is accepted or the contract sanctioned.
- e- the locality from which the billing is made.
- f- the locality where the products are manufactured.

More generally, the sales may be construed as the sale of goods within the locality wherever manufactured or the manufacture of goods within the locality wherever sold.<sup>(1)</sup>

In the U.S.A., the Massachusetts formula which is gradually spreading, is interpreted differently in the different states, as between Arizona, Colorado, Kentucky, New Mexico. This fact impairs the beneficial effect of uniformity.<sup>(2)</sup>

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(1) Federal, State and Local Government Fiscal Relations.  
op.cit. p.429.

(2) Blakey and Johnson : op.cit. p.68.

### III. Argentine Provincial Business Taxes and Overlapping.

In Argentina, the overlapping in provincial business taxation, is not only intra-local but also inter-local.

As concerns the first aspect, it is clear that the imposition, by the one and the same jurisdiction, of license taxes as well as profitable activities taxes, entails multiple taxation on provincial businesses. An example, in this respect, is afforded by the Province of Corrientes.

As for the second aspect, namely inter-local overlapping, it can be illustrated with reference to the situation in Buenos Aires where both the provincial authorities and the municipal authority of Buenos Aires levy almost the same sort of tax on annual gross receipts since 1949.<sup>(1)</sup>

The outcome was clearly a great deal of conflicts and confusion. In consequence, the two taxing authorities reached an agreement which it would be interesting to reproduce in order to reveal the main issues which lie under inter-area duplicate taxation:<sup>(2)</sup>

Article 1 - The profitable activities to which the present

(1) See Chapter One on "Fiscal Inequities and Inequalities," Section III "Local Business Taxation."

(2) Economía y Finanzas. Buenos Aires. June, 18, 1953.  
p.34.

agreement refers are those which are exercised - in one, in several, or in all their stages - in both jurisdictions, but whose gross receipts, originating through a single process, economically inseparable, ought to be attributed jointly to the two.

Article 2 - Save that provided for particular cases in the following articles, each Treasury will tax, of the total gross receipts originated by the activities that are the object of the present agreement, the proportional part of the effected expenditures supported in its jurisdiction when any of the following circumstances is verified:

- a) the industrialization takes place in one jurisdiction and the commercialization in the other, either totally or partially.
- b) all the stages of industrialization and commercialization take place in one jurisdiction, but the direction or administration is exercised in the other;
- c) the principal seat of the profitable activity is in one jurisdiction and there is effected regular sales or purchases in the other through the intermediary of agents, branches, etc. The accidental, purchase by mail, or in any form that does not amount to a regular activity, will not be considered as a taxable activity in the jurisdiction in which realized.



Article 3 - In the cases of construction companies that have head office in one jurisdiction and execute works in another, the same criteria as above will be followed, except any amount in concept of salaries to engineers, architects, etc. in the employ of the business cannot be deducted from gross receipts.

Article 4 - In the cases of insurance, capitalization, and saving companies that exercise activities in both jurisdictions, there will be taxed in each one of them that part of the premiums, quotas or contributions that amount to a remuneration for their services, the income of securities, and whatever other investment of their reserves, in proportion to the expenditures supported in it. The income from real estate will be taxed in the jurisdiction in which the same is located.

Article 5 - In the cases of banks whose principal seat is in one jurisdiction, but which have branches in another, each Treasury will tax the gross receipts of the establishments situated in its jurisdiction.

Article 6 - In the cases of transportation companies that exercise their activities in both jurisdictions, each one will tax that part of the gross receipts corresponding to the passengers and freight contracted in it.

Article 7 - In the cases of the liberal professions exercised by persons that have their offices in one jurisdiction, and exercise activities in the other, each jurisdiction will tax one-half of the salaries provided by these activities.

Article 8 - In the cases of auctioneers, commissionists, etc., that have central office in one jurisdiction and operate in the other, each Treasury will tax one-half of the gross receipts of these operations.

Article 9 - In the cases of mortgage lenders that are not organized in form of businesses, and that have their domicile in one jurisdiction and the guarantee is constituted on real estate in the other, each jurisdiction will tax one-half of the gross receipts originated by these operations.

Article 10 - The expenditures that are mentioned in Articles 2, 3 and 4 and that must serve as the base for distributing the gross receipts between both jurisdictions, are those that originate through the exercise of the activity taxed. Also computed as expenses: wages and salaries, fuel, repair and conservation, rent, insurance premiums, advertising, interest, taxes and the amortizations allowed by the income tax law. The cost of raw materials and commodities will not be considered as expenses.

## SECTION V.

### Local Death Taxation.

The resort, by junior governments, to taxation at death, bristles with inter-area entanglements, and central-local duplicate burden. These problems are ushered in by the co-existence of the same type of tax at different levels as well as by the diversity in tax provisions.

Various factors are deemed to aggravate the problem in modern conditions:

The expansion and diversification of wealth and income and their dispersion all-over the regional areas of the same country in an uneven way. This situation is, inevitably, conducive to horizontal overlapping owing to the knotty points of domicile, residence and situs.

The scramble for resources, motivated by the new socio-economic philosophy, involves the minor authorities in an unhealthy competition inter se or with major authorities for appropriation of large shares at death. The outcome is a diversity of imposts by type (estate taxes, inheritance taxes and other variants) and by region, causative of an unfair fiscal burden.

The entrenchment in federal countries, since the World Wars, of federal government upon the death tax field, which was generally considered as a right of subordinate authorities. The reason for the latter fact, was that the death taxes were viewed as

direct taxes and these, in turn, were constitutionally reserved to the states or provinces.

From the standpoint of overlapping and multiplicity, the death taxes must be either federal or regional. The federal taxes are largely a replica of the state or provincial taxes and, as such, constitute a duplication. Clearly, it is highly desirable to centralize the death taxes. If, however, they continue to be imposed by more than one layer of government, there ought to exist an adequate system of tax crediting whereby a tax credit is granted against the central (or federal) tax for the payment of the regional tax (state or provincial). Moreover, inter-regional uniformity in tax provisions must be introduced or fostered. If the tax credit does not absorb the entire local tax and if the local tax provisions exhibit diversities, there will still be scope for duplication and overlapping. The practice in the U.S.A. provides, in this respect, considerable instruction. The tax credits are not only partial, but are also computable on an obsolete tax base.<sup>(1)</sup>

#### I. Inter-Local Overlapping.

An illustration of the confusion and intermingling which accompany territorial death taxes, is afforded by an example.

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(1) See Chapter I, Section IV.



A decedent may be a resident of locality A, his heir a resident of locality B. The wealth consists of real property in locality C, shares or stock (intangibles) deposited in locality D. The business's physical assets represented by the intangibles are scattered in several localities E, F, G. This business sells in many local areas H, I, J, in the country under consideration.<sup>(1)</sup>

Locality A can have a claim to impose death taxes on the basis that the deceased was domiciled there. The tax reaches all the decedent's property including movable property existing in other areas, according to the principle "mobilia sequuntur personam." The thesis of locality A thus assumes that the taxable situs of the bequest is in the locality of the decedent's residence. Locality B can lay a further claim based on the fact that the heir is domiciled within its boundaries. Locality C is also entitled to tax since the real property is situated there. Locality D has a similar right as regards intangibles.<sup>(2)</sup>

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(1) At the death of a wealthy tobacco manufacturer in the U.S.A., some time ago, it was claimed that his wealth was formed through the contribution of farmers and consumers all over the country and that no one state could tax alone just because the deceased happened to reside there.

(2) Groves, Harold : "Financing Government." New York, 1945. pp.238-240. See also: Federal, State and Local Government Fiscal Relations" 78th Congress, 1st Session, Senate Document No.69, Washington, 1943. pp.241-248.

Other localities may claim to tax a proportion of the shares equal to the real property they represent when that property is located within their confines. This would lead to the taxation, by a local unit, of a non-resident on shares in business concerns owning physical property in that local unit. The basis of this view is that the concern is a legal fiction and is merely an agent for its stockholders and that the stockholders are entitled to acquire real assets by winding up the company. This source of overlapping actually obtained in the U.S.A. in some states but is no more allowed (since it was objected to by the Supreme Court in 1939<sup>(1)</sup>).

In the writer's view, the company and shareholders are separate entities. Legal right to all the concern's property is vested in the concern itself and not in the shareholders.

It thus appears that intangible property is an important source of inter-area confusion. Local tax grabbing results in a tendency to adopt the most suitable (or profitable) basis for the local budget. Industrialised localities would be naturally inclined to adopt residence as a justification for taxation since the local residents, capitalists or more generally investors, own proportionately more intangibles than residents in less industrialised or less populous areas (for instance agricultural). The latter areas, judging that the

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(1) Groves, Harold : "Financing Government." p.239.

principle of residence does not suit them , would prefer to adopt other bases notably the location of intangibles.

Such conditions obtain in countries like Canada and U.S.A. where some subordinate units are markedly more industrialised than others. In Canada, the prosperous provinces of Quebec and Ontario can be contrasted with other provinces. In U.S.A., the eastern states, controlling the bulk of the country's capital prefer residence, whilst the western and southern states clearly prefer the principle of situs.

Domicile is a source of considerable confusion and is responsible for much overlapping. Domicile rests on intent which is a difficult thing to prove. More than one domicile may be assigned to the subject-matter of taxation. The inter-local differences in the interpretation of domicile also result in duplicate taxation.(1)

The general problems outlined so far can be made more intricate by the special circumstances prevailing in some countries.

In the U.S.A. the states which granted the corporation's charter possess the power to subject its intangibles to

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(1) Committee on Intergovernmental Fiscal Relations - Intergovernmental Relations in the Death Tax Field: Multiple Taxation, in Groves, Harold : Viewpoints on Public Finance. p.233. Also: Burkhead, Jesse V. : Double Taxation and Jurisdiction to Tax: Bulletin, National Tax Association No.9. June 1940

taxation even though the owner of the intangibles is not a resident of the chartering state. Some of these states went so far as to tax such shares when transferred from a deceased non-resident to a non-resident recipient. Although this practice was made illegal by the Supreme Court in 1932, it was re-instated in 1942,<sup>(1)</sup> thus sowing the seeds of more tax confusion in future.<sup>(2)</sup>

## II. Local Reciprocal Agreements and Overlapping.

Inter-Local multiplicity may be alleviated through reciprocal agreements between the local taxing jurisdictions. This should be especially resorted to in the case of the taxation of intangibles of non-residents which should be exempted. Naturally a locality giving such exemption without reciprocity is at a disadvantage.

The remedy suggested is not easy to generalise owing to the fact that the less wealthy and less populous local areas which stand to gain financially more from the taxation of non-residents than from that of residents, would be disinclined to grant exemption of non-resident's intangibles even with

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(1) Maxwell, J.A. : "The Fiscal Impact of Federalism in the United States." Cambridge, Massachusetts, 1946. p.349.

(2) National Tax Association, Proceedings of the National Conference on Inheritance and Estate Taxation, New York, 1925.



reciprocity.<sup>(1)</sup>

An interesting complication may arise in some countries. Intangibles may be bought in connection with a business in a state in U.S.A. in order to acquire a business situs there, but the state may consider that the basis of taxation is the location of intangibles and not the owner's domicile. The owner may escape taxation altogether if his intangibles are located in a state that gives reciprocity while he is residing in still another state.

Accordingly, some American states, e.g. New York, exclude from reciprocity agreements intangibles owned by non-residents with an aim to acquire a business situs in the state.

Chaotic overlapping was prevalent in Canada, too, before World War II. Problems, similar to those sketched above, assumed great proportions especially in connection with intangibles. Professor Harvey Perry notices that; "there has been constant litigation as to the situs of deposits in a branch bank, real estate mortgages, negotiable instruments, bonds and shares of incorporated companies and simple contract debts."<sup>(2)</sup>

The transfer taxes were indeed, in Canada, an important

(1) Report of Committee of the National Tax Association on Reciprocity in Inheritance Taxation. National Tax Association, Proceedings, 1927. p.414.

(2) Perry, Harvey : "Taxation in Canada." Toronto, 1951. p.193.

source of provincial revenue prior to last war and yielded more than the corporate and individual income taxes together even in 1937. The achievements of the agreements, which were reached between 1907-1937, were unsatisfactory as far as overlapping is concerned. They were often formal and seldom effective.

Besides, Quebec and Ontario, the richest provinces were adamant in refusing to cope with the problem. Cancellations of agreements followed in succession after 1937. Alberta notably cancelled its arrangements with Ontario, British Columbia and New Brunswick. Before World War II there remained only the agreement between New Brunswick and British Columbia.

Recently, however, much overlapping was mitigated after the Dominion-provincial Tax Rental Agreements referred to above.

overlapping (or eventually evasion). Two main factors cause this situation.

First: The financial pressure on the local budgets induces the junior authorities to resort to a practical, cheap and lucrative source of revenue, namely the consumption taxes. The rise in living standards, the increasing urbanisation and the diversification of consumption militate in favour of this tendency. The local expenditure taxes are thus increasing in number, coverage and rates. The outcome may be an intricate type of heterogeneous imposts eventually alternative to those especially in a federal polity with multiple taxing jurisdictions.

(1) Eushler, Alfred : Public Finance. New York, 1948. pp.428-434.

## SECTION VI.

### Local Outlay Taxes.

Horizontal and vertical overlapping make their appearance in this field if the lower tiers of government are empowered to lay substantial indirect imposts. The customs duties have long been relegated to the central level. The excise taxes are now half-way. By far, the most serious menace of confusion and intermingling stems from the increasing tendency towards local taxation of sales under various forms; general, specific, wholesale or retail taxes, single-point or multi-point.

The danger looms large and portends serious duplicity and overlapping (or eventually evasion). Two main factors cause this situation.

First: The financial pressure on the local budgets induces the junior authorities to resort to a practical, cheap and lucrative source of revenue, namely the consumption taxes. The rise in living standards, the increasing urbanisation and the diversification of consumption militate in favour of this tendency. The local expenditure taxes are thus increasing in numbers, coverage and rates. The outcome may be an intricate maze of heterogeneous imposts eventually conducive to chaos especially in a federal polity with manifold taxing jurisdictions.

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(1) Buehler, Alfred : Public Finance. New York, 1948.  
pp.428-434.

Second: The federal governments which, hitherto, generally left their minor authorities with this field, now begin to entrench upon it.

A word may now be said, before further development, about inter-local commerce.

Although inter-local transactions in the U.S.A. may not be taxed, the courts generally upheld the doctrine that "interstate commerce may pay its way." The differences in fiscal regulations between the states do not make it possible to put inter-state transactions on an equal foot with domestic transactions. If both states involved tax inter-state commerce, duplicate taxation ensues. On the other hand, if both authorities abstain from imposing any tax, in an attempt to protect such transactions, complete exemption results.<sup>(1)</sup>

Non-taxing areas. However, the other localities may also have sales taxes or may levy taxes at a later time. Consequently, if the former locality does not provide for credits to offset outside taxes, the local residents, paying the compensatory taxes on "imported" commodities, find themselves subject to double taxation.

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(1) Newcomer, Mabel : Taxation and Fiscal Policy.  
New York, 1940. p.60.

(2) Kurz, Harley Loist : Public Finance.  
New York, 1950. p.334.



# I. Overlapping in Local General Sales Taxes. (1)

Intra-local overlapping may be caused by the co-existence of various types of general sales taxes including the taxes on gross income or gross receipts.

Inter-area overlapping is accentuated by a widening and/or deepening of the coverage of such imposts. A widening is a horizontal spreading of the tax embracing a larger number of commodities. A deepening is a vertical movement of the tax subject from the retail stage to the manufacturing stage.

A further source of multiplicity could be pointed out. The junior taxing authorities may be driven to levy compensatory taxes on commodities "imported" from adjoining localities in an effort to safeguard their revenue since the local residents may make direct purchases especially in the non-taxing areas. However, the other localities may also have sales taxes or may levy taxes at a later time. Consequently, if the former locality does not provide for credits, to offset outside taxes, the local residents, paying the compensatory taxes on "imported" commodities, find themselves subject to double taxation.

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(1) The general sales taxes comprise a wide range of products and are imposed at one or more of the following stages; manufacturing, wholesale, retail. The specific sales taxes are laid on individual commodities separately.

(2) Lutz, Harley Leist : Public Finance.  
New York, 1936. p.634.

It is noticeable that an unnecessary burden is laid on the non-resident, who is momentarily staying in the taxing locality, and who buys from the non-taxing locality since the non-resident may intend to use, or consume, the commodity in his locality of residence.<sup>(1)</sup>

The local compensatory taxes are akin to the old tolls and, as such, constitute a hindrance to inter-local trade if pushed too far as will be seen in due course.<sup>(2)</sup>

In the U.S.A., twenty-seven states, in 1948, had sales taxes of sufficient coverage to be considered as general sales taxes. Although some applied to manufacturers and wholesalers, most referred to retailers.<sup>(3)</sup> In Washington and West Virginia, there are both retail sales taxes and gross receipts taxes.

Few American municipalities had retail sales taxes prior to World War II. Examples are New York City, New Orleans, St.

(1) Lowndes : State Taxation of Interstate Sales. National Tax Association, Proceedings, 1934. pp.139-148.

Haig and Shoup : The Sales Tax in The American States. New York, 1934. p.92.

Groves, Harold : Financing Government. New York, 1945. p.310.

(2) See Part Two, Chapter IV "Intergovernmental Fiscal Policy Conflicts."

(3) Snider, Clyde F. : American State and Local Government." New York, 1950. pp.575-576.

Smith, Lewis H. : Taxes and Economic Incentives. Washington, 1950. pp.130-131.

Perry, Henry J. : Taxation in Canada. Toronto, 1951. p.33. The Dominion Manufacturers' sales tax is so important that it yielded in 1946 9.3 per cent of the national government's tax collections.

Louis and Kansas City. After the Second World War, the number of taxing municipalities increased. In 1948, 50 cities of over 10,000 population impose retail sales taxes, 42 are in California.<sup>(1)</sup>

In Canada, there is a Dominion manufacturer's sales tax of 10 per cent and Provincial retail sales taxes in Quebec, New Brunswick, British Columbia, Newfoundland, Saskatchewan. There are also retail sales taxes in municipalities, notably Montreal and Quebec City and several other cities in the province of Quebec.<sup>(2)</sup>

As for the compensatory taxes, referred to above, they are actually levied in the U.S.A. by most of the states (except four) and some municipalities (which have sales taxes) under the name of "use taxes". The use taxes are imposed on use, consumption or storage of commodities purchased outside the taxing jurisdiction and which, if purchased inside the locality, would have paid the local sales tax. Seven states out of the states applying use taxes, do not provide a credit and consequently open the door to duplication.

The following tables disclose the increasing role played by the sales taxes imposed by the states, municipalities and other minor authorities in the U.S.A.

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- (1) The most usual rate is 0.5%. Some cities levy 1%. See: Kimmel, Lewis H. : Taxes and Economic Incentives. Washington, 1950. pp.130-131.
- (2) Perry, Henry J. : Taxation in Canada. Toronto, 1951. p.33. The Dominion manufacturing sales tax is so important that it yielded in 1946 9.3 per cent of the national government's tax collections.

U. S. A.1. Relative Importance of State Sales Taxes. (1)

## Percentages

Year	Sales Taxes (a)	Motor-Vehicle Taxes	Net Income Taxes
	%	%	%
1931	26.99	16.47	10.07
1938	48.27	12.13	12.84
1941	52.41	12.89	12.19

(a) These cover general sales taxes and various specific taxes notably on gasoline, tobacco, liquor and soft drinks.

2. Sales Tax Yields in Selected Cities. (2)

City	Percentage of City Revenue
New York City	3.1
St. Louis	5.4
Kansas City	2.8
New Orleans	40.0

(1) Hansen and Perloff : "State and Local Finance in The National Economy." New York, 1944. p.64.

(2) Somers, Harold : "Public Finance and National Income." Toronto, 1948. p.442.



3. Sales and Use Taxes as Percentages of Total State  
Tax Collections.

Selected States - 1947 (1)

State	Per Cent of total taxes	State	Per cent of total taxes
California	34.5	Missouri	41.7
Colorado	31.6	North Carolina	18.3
Illinois	39.4	Ohio	28.9
Indiana	36.0	Oklahoma	24.1
Iowa	34.9	South Dakota	32.2
Kansas	35.2	Utah	30.7
Louisiana	12.0	Washington	44.3
Michigan	47.7	West Virginia	53.1

(1) Buehler, Alfred : "Public Finance." New York, 1948. p.346

4. Sales Taxes and Motor-Vehicle Licenses as Percentages of Total State Tax Collections. (1)

Fiscal Year	Including Payroll Taxes	Excluding Payroll Taxes	Fiscal Year	Including Payroll Taxes	Excluding Payroll Taxes
1931	43.5		1936	61.2	61.7
1932	47.0		1937	54.5	60.6
1933	49.7		1938	48.8	60.4
1934	57.5		1939	49.8	62.7
1935	61.1		1940	51.2	64.4
			1941	52.4	65.3

Public sales taxes covers the triple-distilled tobacco, gasoline and liquor taxes.

Importance of Tobacco, Gasoline and Alcoholic Beverages Taxes 1939 (Millions of Dollars) (2)

Tax	Federal	State	Local	Total
Gasoline	207.0	360.1	4.4	1,511.5
Alcoholic Beverages	587.5	212.1	3.3	803.0
Tobacco	597.9	58.0	3.1	642.9

(1) Hansen and Perloff : op. cit. p.37

(2) Tax Research Foundation, Tax Systems, 2nd ed., Chicago, 1940. p.314.

## II. Overlapping in Local Specific Sales Taxes.

Inter-area and central-local overlapping and multiplicity may also exist in the case of the specific sales taxes if both central and junior authorities levy sales taxes on the same individual items. In order to study the implications of this case let us take some instances from the U.S.A. where selective sales taxes are not only levied by the states but also by lower authorities including many municipalities. In 1948 37 cities levied tobacco taxes, 26 cities had taxes on alcoholic beverages and 30 cities had motor fuel taxes.<sup>(1)</sup>

Our investigation of overlapping in the field of the specific sales taxes covers the triple-deck tobacco, gasoline and liquor taxes.

Importance of Tobacco, Gasoline and Alcoholic Beverages Taxes 1939 (Millions of Dollars) (2)

Tax	Federal	State	Local	Total
Gasoline	207.0	800.1	4.4	1,011.5
Alcoholic Beverages	587.5	212.1	3.3	803.0
Tobacco	597.9	58.0	5.1	642.9

(1) Kimmel, Lewis : op. cit. pp.130-131.

(2) Tax Research Foundation, Tax Systems, 8th ed., Chicago. 1940. p.314.

Tobacco Taxes: Much overlapping, or alternatively evasion, occurs as three layers make use of them: the Federal Government, the states<sup>(1)</sup> and the municipalities.<sup>(2)</sup>

The states collected the tax from wholesalers, but sometimes from retailers in case the latter buy across state boundaries. Use taxes are resorted to in case of consumers' outside purchases.

It is worthy of note that much evasion, the counterpart of overlapping, occurs in inter-state sales of cigarettes. There is probably 20 per cent evasion. The wholesalers can settle near the border and obtain direct orders from consumers in the neighbouring taxing state. The consumers can also escape the tax through mail purchases. Furthermore, it is sometimes difficult to follow the sales along their voyage: they may be made in one subdivision, shipped in another and billed from a third.

In the writer's view, the tax should be left to the Federal Government and some sort of tax sharing should be adopted possibly on the basis of local population.

Gasoline: This is an important source of revenue for the Federal Government and the minor governments. All states levy

(1) The states entrenched increasingly upon this field since 1921. In 1941 there were 29 taxing states. By the end of 1949, there were 40 states.

(2) Such as St. Louis, Kansas City, Birmingham and many cities in Florida. See: Tax Institute "Tobacco Taxes", Tax Policy. vol.9 No.1. November, 1941.



gasoline taxes and the rates range from 2 cents to 9 cents per gallon.<sup>(1)</sup> The tax is also imposed by many localities and municipalities, such as Alabama, Missouri and New Mexico, and a few countries.

As a source of overlapping, the gasoline taxes afford an important example and come after income taxes and payroll taxes.

The following table discloses the amount of overlapping.<sup>(2)</sup>

	Yields 1940	% of Total Yields
Federal	\$ 257,420,000	23
State	852,674,478	76
Local	4,500,000	1
Total	1,114,594,478	100

There is much tax avoidance in connection with inter-state shipments especially as distributors operating in a certain number of states with varying tax rates can pay the lowest rates and sell in the state with the highest rates.

Nearly all states have "use taxes" on purchases outside the state. This leads to the problems already discussed.<sup>(3)</sup>

(1) In 1948, the state revenues amounted to about 1.3 billions. A portion goes to local authorities. See, Kimmel, Lewis. op.cit. p.130

(2) Federal, State and Local Government Fiscal Relations. Senate Document No.69. Washington, 1943.

(3) Henry, Thomas P. : "The Motor-Vehicle Tax Problem." in Groves, Harold: Viewpoints on Public Finance. New York 1947. p.376.

Tax sharing here would be also preferable.

Liquor Taxes: Multiple taxation and overlapping stem from two facts. First, all three levels of government make use of liquor taxes. Second, they affect various forms and have different rates: besides the specific excise taxes, there are occupation taxes, license taxes on distilled spirits, wine and beer.<sup>(1)</sup>

A further point is worthy of notice. According to the twenty-first Amendment a state is free to impose discriminatory taxes. Michigan, recently, imposed its own products 4 cents (per gallon) as against 50% on outside products. Discrimination is thus also practised between state and state and not merely against outside products. "Wars of Retaliation" and "Border Wars" naturally ensued.

### III. Sales Taxes and Evasion.

A certain amount of evasion takes place where intermediate and tertiary authorities resort to sales taxes as in the U.S.A. and India, especially in the single-point system. A trade estimate puts the evasion in the State of Bombay at about 50 per cent and in some markets as high as 70 per cent.<sup>(2)</sup>

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(1) Groves, Harold : Financing Government. p.303.

(2) The Economic Weekly. (Indian Periodical). Jan., 26. 1953.

Various incentives induce evasion particularly when business is slack and competition is keen. The consumers also play their part for their own benefit.

Apart from the traders' desire to enhance profit-making by appropriating the equivalent of the tax, there is the desire to cut prices to compete with other traders and the attempt to escape income taxation.

The methods used for sales-tax avoidance, are numerous. The following may be mentioned.

1. Purchasing goods on cash without receipts or selling them without book-entries or cash memos.
2. Obtaining false receipts from private road carriers showing that the commodities have been sold outside the taxing locality while in fact they are being sold internally tax-free.
3. Buying outside the taxing area and selling inside without reference in the accounts. The outside dealers are under no obligation to submit returns to other taxing authorities.
4. Trading on bogus registration numbers. Sales tax registration numbers could be obtained cheaply in the name of bogus firms or they may be acquired from traders going into liquidation. The commodities would thus be sold without taxation.<sup>(1)</sup>

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(1) The Economic Weekly. op.cit.

In India, meddling in registration numbers has become, in some cases, a regular business.

It is noteworthy that the recourse to the multi-point sales tax system would practically eliminate the latter factor.

Last, but not least, it appears that evasion is fostered by non-efficient administrative machinery, lack of honesty among government officers and the inability of the minor governments to check inter-area transactions.

Furthermore, the lack of uniformity in the taxes as imposed by the different lower authorities, cannot but militate in favour of tax avoidance.

Clearly, the centralisation of the sales taxes, and the distribution of the proceeds according to some criterion, would cope with the problem if the assent of the local authorities, or the federating states, could be obtained.



PART TWO

INADEQUACIES

### CHAPTER THREE

#### REVENUE INADEQUACY

ROBERT H. ROBERTS, "The Economics of the Welfare State,"  
 "Wirtschaftslehre,"  
 Vol. I, Grundriss, 1935, P. 260. See also  
 Harold D. Williamson, "Financial Management," New York,  
 1934, P. 468-470.

## P R E L U D E

TWO changes, one quantitative and the other qualitative, exerted major effects on local expenditures.

WAGNER pointed ~~out~~ to the tendency for central and local expenditures to increase steadily. In his well-known law, he asserts that:

"Comparison of the past and present situation of different countries shows that among progressive peoples, with which we are alone concerned, an increase regularly takes place in the activity of both the central and local governments. This increase is both extensive and intensive; the central and local governments constantly undertake new functions; while performing both old and new functions more efficiently and completely. Public economic activities increase at the expense of private economic activities, and the collectivistic character of the whole national economy becomes in consequence, more pronounced." (1)

The "Welfare State", as successor to the "Liberal State", was further responsible for an upsurge of expenditures to cope with new services or promote the standards of already performed services. Social services, health, education and other aspects of welfare were either created or developed.

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(1) WAGNER, Adolph: "Allgemeine oder theoretische Volkswirtschafts-lehre."

Vol. I, Grundlegung 1876 P.260. see also

GROVES, Harold: "Financing Government." New York, 1945.  
PP. 468-484

War and the inflationary price movements have a definite impact on central and local expenditures by reason of the rise in the costs of administration and services.(1)

The qualitative changes are functional changes. Centripetal forces, set off by the new concept of economic planning or simply by war, induced structural changes in local finances. These centripetal forces are two-fold. They involve a transfer of functions from the local level to overlying layers or to the central level. They also involve a shift of local revenue sources to intermediate authorities or to the central level. The two required movements are traceable in unitary and federal countries alike.

To the extent that functions are taken off the shoulders of subordinate government units, the move towards the centre mitigates the local financial burden. However, the transfer of revenue sources has an opposite effect since it deprives the local budgets of funds.

The net effect of these two constituent elements of the centripetal forces depends on their relative strength.

The result was detrimental to the local treasury whether in unitary or federal countries

- (1) SYKES, Joseph: "A Study in English Local Authority Finance." London, 1939. pp 1-58
- (2) BUEHLER, Alfred: "Public Finance." New York 1948 p.52-88  
HANSEN and PERLOFF: "State and Local Finance in the National Economy." New York 1944. pp.1-34



In federal countries, the entrenchment upon the lower governments' taxes was already gaining ground before World War II. During and after the Second War this tendency made headway. In Canada and Australia the lucrative income taxes were monopolised by the federal government. Although agreements granted compensations to the provinces or states, these subordinate units were virtually deprived of a potential source of income which is irreplaceable.

In unitary countries, some transfer of local revenue sources took place. Indeed the wave of nationalisations depleted the local trading profits by weakening municipal socialism that was in vogue in some countries. The vital factor in the embarrassment of the local finances in unitary countries is the inherent inelasticity of the local fiscal powers in those countries, further accentuated by the inflationary spiraling of prices.

It is worthy of note that the alleviative element of the centripetal forces, viz. the centralisation of services is not absolute. New responsibilities are constantly added to the local authorities. In federal countries, some services even reverted to the state level as happened, for instance, after the Second World War.

ENGLAND AND WALES

Increase in Local Expenditure (1)

Year	Total Expenditure £ 000,000	Expenditure per head £
1875	28.8	1.26
1880	36.3	1.46
1885	44.1	1.62
1890	48.2	1.68
1895	59.7	1.96
1900	76.0	2.36
1905	107.7	3.17
1910	125.8	3.52
1915	153.3	4.11
1920	265.5	7.07
1925	354.9	9.12
1930	425.1	10.68
1937	484.6	11.8
1942-3	694.3	16.4
1944-5	729.1	17.0
1945-6	779.9	-

(1) FINER, Herman: "English Local Government."  
London 1950. p.394

U. S. A.

1 - Increase in State Expenditure 1890 - 1946  
(Millions of Dollars) (1)

Year	Amount	Year	Amount
1890	77	1940	3,612
1903	182	1941	3,585
1913	359	1942	3,644
1920	789	1943	3,503
1925	1,479	1944	3,588
1930	2,152	1945	3,797
1935	2,396	1946	4,416

2 - Increase in Expenditures of Local Governments  
1890 - 1946  
(Millions of Dollars) (1)

Year	Amount	Year	Amount
1890	487	1940	5,640
1903	913	1941	5,553
1913	1,783	1942	5,219
1920	4,035	1943	4,873
1925	5,196	1944	4,604
1930	6,071	1945	5,015
1935	4,583	1946	5,121

(1) Grants from other governments, trust-fund financing and debt retirement are excluded in both tables. The amounts for 1946 in the first table and 1944 and 1945 in the second are preliminary.

UNION OF SOUTH AFRICAIncrease in Provincial Expenditures 1911 - 1947 (1)

Year	Amount £	Year	Amount £
1911-12	2,883,569	1931-32	11,557,257
1918-19	5,212,710	1935-36	13,835,803
1920-21	8,417,256	1939-40	16,539,398
1927-28	10,549,670	1944-45	24,375,388
		1947-48	37,873,629

AUSTRALIAIncrease in State Expenditure 1938-1948 (2)

( £'000 )

Year	Total £	Per Head (a)	Year	Total £	Per Head
1938-39	128,159	18/10/8	1946-47	173,857	23/4/1
1944-45	167,238	22/16/9	1947-48	197,720	25/19/6
1945-46	165,588	22/7/5	1948-49	226,425	29/3/0

(a) Based on men population of each financial year

(1) Official Year Book

Union Office of Census and Statistics, Pretoria.

No.25 - 1949

P.616

(2) Official Year Book of the Commonwealth of Australia

No.38 - 1951

P.806



## SECTION : I

LOCAL ECONOMIC VULNERABILITY

The introduction was a foretaste of the financial difficulties which loom in local budgeting. We now analyse the factors which account for the inherent inadequacy of the local taxing powers.

The fiscal capacity of a local area is based on its economic capacity. A study of the latter thus reveals the revenue potentials of the area.

When the various factors of production are considered in connection with the subordinate units of government, the following points can be noticed

I The Uneven Inter-Local Distribution  
of Economic Resources:

The factors of production, capital, labour and management, are unevenly spread over the local units of a given country. Some localities may be endowed with rich resources(1) and possess a high revenue potential and tax windfalls resulting from the existence of investment projects. Other localities

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(1) Such as mineral resources, industrial equipment, good transportation system, accessibility to markets, skilled labour.

may suffer from inadequate resources and may lack taxable funds. No necessary corollary can be expected to exist in a restricted area between needs and taxable resources.

The population is unevenly spread over the country's subdivisions. A large proportion may be concentrated in one area and the ratio of population to natural resources becomes high. In Germany more than half of the total population was in Prussia. In Australia, Canada, the Union of South Africa and Argentina more than one-fourth of the population is in a single state. Among the federal countries, the U.S.A. and Mexico are the only ones where 10 per cent or less of the population is located in the largest state (New York and Vera Cruz respectively).(1)

In some countries for instance the Middle East, some local units may have a nomadic population and some others a more settled population. In the former case, the taxable resources may not be always easy to reach.

The result is the existence of inter-local disparities in per capita wealth and per capita income. These increase in direct proportion to the number of multiplex and small local units.

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(2) Stateman's Year Book.

It is worthy of note that, under perfect competition, the population tends to migrate from poor regions to rich ones in such a way as to smooth differences in per capita income. Wealthy areas would have correspondingly more people to support.

Under conditions of controlled economy, the local economic and fiscal capabilities feel the impact of national planning. The inter-area discrepancies may be either accentuated or mitigated. The effect of central planning and full employment policies on local taxable capacity will be more appropriately discussed next section.

The deficiency of local resources and their uneven distribution are conducive to inter-local competition to acquire or retain taxable resources. This strife may lead to economic maladjustments and to disharmony in local tax systems. Efforts to co-ordinate the latter become difficult. Pressure groups and local vested interests constitute a hindrance to co-operation.

Professor Hansen and Professor Perloff remark that, "Throughout the country, the existence of small local units makes for inequality in tax burdens, with some units reaping the gains of unjust enrichments while the residents of other units must bear an unduly heavy burden in taxes." (1)

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(1) HANSEN, A. and PERLOFF, H.: "State and Local Finance in the National Economy." New York 1944 P.85

The unequal distribution of economic and taxable resources carries important implications in under-endowed areas which are only *local monotaxing or* monotaxing or semi-monotaxing powers often prevail in unitary countries. In such cases, the local authorities are deficient in or deprived of the right type of taxable resources, find themselves in a vulnerable position.

The situation in a federal polity is different. Here the underlying units of government are often pluritaxing. They have the choice between a wider variety of levies and can adopt those more in line with their natural endowments. However, this pluritaxing capacity may be badly exploited. The local unit, in its lust for funds may turn to inequitable imposts, hardly related or totally unrelated to ability to pay. Local business may be subject to taxes on nominal capital, gross receipts and other fees. Outlay taxes, especially sales taxes, may be multiplied. The simplest canons of taxation will be thus infringed.

On the expenditure side, the uneven distribution of resources may result, in some localities, in higher costs for the same service, in sub-standard services or in a smaller amount of services per capita.

(1) Summarised from:

Report of the Local Government Boundary Commission,  
For the Year 1946

H.M.S.O., London, 1947

PP. 6-7



TABLES: I.

REGIONAL POPULATIONS AND AREASENGLAND AND WALES

## 1. Inter-Area Disparities in Population and Rateable Value (1)

(Excluding the County of London)

Denomination	Population	Product of 1d Rate
<u>1. Administrative Counties</u>		
Largest	2,186,000	88,143
Smallest	17,820	466
<u>2. County Boroughs</u>		
Largest	1,063,000	29,125
Smallest	23,780	855
<u>3. Non-County Boroughs.</u>		
Largest	178,590	7,600
Smallest	876	12
<u>4. Urban Districts</u>		
Largest	211,550	8,550
Smallest	707	16
<u>5. Rural Districts</u>		
Largest	79,940	1,102
Smallest	1,200	98

(1) Summurised from:

Report of the Local Government Boundary Commission,  
For the Year 1946

H.M.S.O. London, 1947

PP.6 - 7

2 -

POPULATION DISTRIBUTIONBETWEEN COUNTIES AND COUNTY BOROUGHES (1)

(Excluding London)

Population Range	Counties	County Boroughs
Less than - 50,000	5	4
50,000 - 75,000	5	16
75,000 - 100,000	3	13
100,000 - 150,000	6	23
150,000 - 200,000	4	11
200,000 - 500,000	24	12
500,000 - 1,000,000	8	3
Over 1,000,000	6	1
	<u>61</u>	<u>83</u>

(1) Report of the Local Government Boundary Commission  
For the Year 1946 P.4

## FEDERAL COUNTRIES

### 1 - DISTRIBUTION OF POPULATION in 9 FEDERAL COUNTRIES (1)

Country	Date	Largest State and Proportion of Population	Smallest State and Proportion of Population
Argentina	1940	Buenos Aires 26.55	La Rioja 0.84
Australia	1938	New South Wales 39.48	Tasmania .38
Brazil	1938	Minas Geraes 17.26	Matto Grosso .85
Canada	1931	Ontario 33.07	Prince Ewd Island .85
Germany	1933	Prussia 61.55	Schaumburg-Lippe .08
Mexico	1930	Vera Cruz 8.32	Colima .37
Switzerland	1930	Bern 16.94	Appenzell I-Rh .34
Union of South Africa	1937	Cape of Good Hope 36.35	Orange Free State 7.91
United States	1940	New York 10.24	Nevada .08

### 2 - LOCAL AREAS in 9 FEDERAL COUNTRIES

Country	Number of States	Largest State by Area	Smallest State by Area
Argentina	14	Buenos Aires 10.97	Tucuman 0.82
Australia	6	Western Australia 32.81	Tasmania .88
Brazil	21	Amazones 22.33	Sergipe .46
Canada	9	Quebec 15.10	Prince Ewd Island .66
Germany	17	Prussia 62.52	Bremen .05
Mexico	28	Chihuahua 12.41	Tlaxcala .20
Switzerland	22	Graubunden 17.22	Basel-Stadt .09
Union of South Africa	4	Cape of Good Hope 58.61	Natal 7.68
United States	48	Texas 8.82	Rhode Island .04

(1) Statesman's Year Book. (The term "state" covers provinces and cantons.)

TABLES: II REGIONAL INCOME AND WEALTH  
GREAT BRITAIN and NORTHERN IRELAND

1 - REGIONAL AVERAGE TOTAL INCOMES ASSESSED. (1)  
BEFORE TAX, 1949 - 1950

Region	£
London and South East	464
Midland	395
East and West Ridings	393
Southern	393
North Midland	392
Eastern	381
Scotland	380
North West	380
South-West	373
Northern	369
Wales	356
Northern Ireland	348

2 - REGIONAL ANNUAL AVERAGE EARNINGS. (1)

Region	Per Earner £	Per Capita (Index)
London and South-East	341	UK 121 100
Midland	320	110
Northern	316	92
North Midland	315	100
Wales	314	82
North-Western	308	104
East and West Ridings	308	102
Eastern	307	82
Southern	302	85
Scotland	300	92
South Western	295	81
Northern Ireland	249	66

(1) DEANE, Phillis, "Regional Variations in United Kingdom Incomes from Employment." Paper read before the Royal Statistical Society, Jan. 1953. Miss Dean, of the Department of Applied Economics of Cambridge University also computed the second table published in an article of:  
UTTING, J.E.G.: "Income Estimates For Small Areas." in Local Government Finance, Journal of The Institute of Municipal Treasurers and Accountants, June 1953. P.146. See Also Report of the Commissioners of H.M. Inland Revenue for the year ended 31st March 1952. H.M.S.O. (Cmd. 8726). The report analyses by counties the 1949-50 income census.



U.S.A. (1)1 - Per Capita Wealth in Selected Taxing Jurisdictions.

Jurisdiction	Per Capita Wealth		
	High Value	Low Value	Ratio of High to Low
6 Regions, 1930	\$4,519	\$1,663	2.7 to 1
48 States, 1930	7,264	1,298	5.6 to 1
316 Massachusetts towns, 1935	10,736	407	26.4 to 1
1,624 Illinois townships, 1938	11,720	365	32.1 to 1
932 New York towns 1929	15,956	370	43.1 to 1
11,378 Illinois school districts 1934	352,109	357	986.3 to 1

2 - Per Capita Income and Per Capita Income Tax Collections  
In Selected Taxing Jurisdictions (1939)

Jurisdiction	High Value	Low Value	Ratio of High to Low
	Per Capita Income		
6 Regions	\$680	\$296	2.3 to 1
48 States	848	203	4.2 to 1
	Per Capita Income Tax liability		
77 Oklahoma Counties	\$3.34	1 cent	334.0 to 1
115 Oklahoma Local Divisions	4.66	2 mills	2,330.0 to 1

(1) Federal State and Local Government Fiscal Relations.

78th Congress, 1st Session

Senate Document No.69

Washington, 1943.

P.190

3 - COMPARISON OF INCOME  
SIX HIGHEST AND SIX LOWEST STATES. (1)

		<u>1940</u>	
Name of State	Income	Per Capita Net Income	Rank of Wealth
Nevada		960	2
Connecticut	252	864	4
New Jersey	191	852	8
Delaware	103	836	18
California	124	819	1
New York	123	814	6
Tennessee	177	325	39
Georgia	213	321	44
South Carolina	207	281	46
Alabama	183	264	45
Arkansas	201	253	47
Mississippi	203	195	48
<hr/>			
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(1) "Federal, State and Local Government Fiscal Relations."  
 op. cit. P.192

Johnson, Byron D.  
 The Principles of Equalization Applied to the Allocation of  
 Grants-In-Aid.  
 Federal Security Agency - Social Security Administration,  
 Bureau Memorandum No. 56, Washington, 1947, P. 111.

4. Range in State Per Capita Income, 1929-45.<sup>1</sup>

Year	National Average Per Capita Income.	Lowest State Per Capita Income.	Highest State Per Capita Income.	Relative Range: Ratio of Highest Per Capita Income to Lowest.	Absolute Range: Difference Between Highest and Lowest Per Capita Income.
1929	\$ 680	\$ 252	\$ 1,191	4.7	\$ 939
1930	596	191	1,179	6.2	988
1931	500	143	1,088	7.6	945
1932	380	125	926	7.4	801
1933	368	123	806	6.6	683
1934	420	162	876	5.4	714
1935	460	177	955	5.4	778
1936	531	218	1,124	5.2	906
1937	561	207	1,107	5.3	900
1938	509	185	1,044	5.6	859
1939	539	201	1,031	5.1	830
1940	575	202	1,080	5.3	878
1941	693	283	1,101	3.9	818
1942	862	396	1,305	3.3	909
1943	1,040	483	1,479	3.1	996
1944	1,133	541	1,519	2.8	978
1945	1,150	556	1,595	2.9	1,039

1. Johnson, Byron L.:

The Principle of Equalization Applied to the Allocation of Grants-In-Aid.

Federal Security Agency - Social Security Administration.  
Bureau Memorandum No. 66, Washington, 1947, p. 117.

## U. S. A.

Disparities in State Expenditures Per Capita, 1944Six Largest and Six Smallest States. (1)

State	Per Capita \$
Washington	84.07
Nevada	71.73
Utah	68.80
California	67.51
Arizona	59.97
Oregon	59.13
Mississippi	25.94
Alabama	28.45
Georgia	28.65
Kentucky	29.21
Arkansas	29.57
Tennessee	30.06

(1) SOMERS, Harold M.: Public Finance and National  
Income. Philadelphia, 1949 PP.417 - 418



## II THE LACK OF DIVERSITY IN LOCAL ECONOMIC RESOURCES:

The distribution of economic resources between local units may be such as to concentrate in one locality a certain type of resources. A given area may be specialised in the production of a certain crop or the manufacturing of a given commodity. Similarly, a local area may be concentrating on export trade, another on imports of specific goods. Two main points of weakness may be pointed out:

(a) Vulnerability to Economic Vicissitudes: By lacking diversity in resources a local unit is exposed to the vagaries of economic conditions. A locality relying on export trade and selling at competitive prices in world markets is clearly more hardly hit by a recession in international trade than a locality producing manufactures for home consumption. This can be noticed in the U.S.A. where the southern states thrive on cotton. In Canada, Ontario will be much affected by a decline in its major exports namely pulp and paper.<sup>(1)</sup> The aftermath of the Korean War affords a further illustration. The wool producing states in Australia were relatively more affected by the drop in prices of raw materials.

Structural, frictional and mass unemployment can be detrimental to particular areas more than others. Indeed, some industries tend to concentrate in certain parts of the country for various reasons. Such distressed areas will be faced with decreased revenue and on the other hand increased expenditures caused by unemployment benefits, health services and costs of combating delinquency and other measures.

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(1) IVOR, David: The Principles of Federal Public Finance. London, 1947. (PH.D.thesis) P.41

Emergencies, especially wars, may have a severer impact on certain localities more than others. Apart from the fact that an area's physical capital may be more damaged, war ushers in vital economic changes. War industries, which crystallise the country's efforts, may be shifted to rural areas thus depriving the locality of origin of sources of income. The rationalisation of industry and the closing of the less efficient plants are not devoid of varying local impact.

The drastic redistribution of manpower by its diversion to particular channels or simply the exodus of population weakens the finances of some localities more than others.

In sum, the impact of the vicissitudes of economic life is felt more severely when a locality is taken separately than when the country is envisaged as a whole.

(b) Vulnerability to Central Economic or Financial Policy:

When a local unit is considered in isolation it may be found more susceptible to economic measures and policies of the national government owing to the concentration within the local boundaries of production factors which are relatively more liable to be affected by central policy.

An illustration is afforded by Australia where a protective tariff policy, fostering secondary industries benefited Victoria, New South Wales and Queensland but did not benefit Western Australia and South Australia specialising in primary production. The latter states often suffered from foreign retaliation (1)

Interventionism and economic planning gave prominence to these vulnerable points in local finances. Direction of labour, industrial location, nationalisation, wage and price policies all affect, in <sup>inter-arts</sup> varying degrees, local revenue and expenditures. Central policies regarding exchange control, tariffs and trade agreements, by fostering certain branches

activity and weakening others, induce surpluses or deficits in local budgets.

### III. THE MOBILITY OF FACTORS OF PRODUCTION

The factors of production, labour, capital and management, move more readily from locality to locality within a given country than from country to country. There are no inter-local, as there are inter-country, hindrances to shifting. There are no local migration laws (as was often the case prior to the Industrial Revolution), no local barriers to trade or local exchange controls. Race, culture and language are the same.

These facts are of primary importance from the viewpoint of local taxation. They set definite limits to the use of local fiscal powers. If these powers are wielded unwisely or excessively, the taxing locality runs the risk of being deprived of factors of production which will tend to migrate to other localities thus generating a local impoverishment in taxable resources.

The efflux of one type of taxable resource, for instance the local income tax, may cause the loss of other tax revenues as well, for example the local property tax. Moreover, liabilities of the locality may be increased.

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(1) GREENWOOD, Gordon: "The Future of Australian Federalism."  
Melbourne, 1946. P.106

IV. THE DILEMMA

The problem of multiplex and restricted local units carries important financial implications. In many countries the subdivisions were created a long time ago when communications were slack and laissez-faire reigned supreme with its concomitant of limited central and local budgets. The old local boundaries are the fruit of confused strife between boroughs and other local communities on the one hand and the central authorities on the other hand in order to secure more "freedom" from central administrative and financial "subjection." However, these historical factors are unrelated to economic conditions. The latter are liable to constant change and have their own laws. The factors of production constantly find different combinations and locations. Demographic movements occur between the various subordinate units. In sum, the traditional local boundaries become obsolete. (1)

In England, no review of the boundaries of counties took place since the Local Government Act of 1888, which also took account of the old boundaries. By the same Act, certain "counties of towns" became county boroughs ~~of~~ *and* populations of 50,000 or more could obtain the same status. Although the minimum population was raised in 1926 to 75,000 and in 1945 to 100,000 no county borough lost its status since 1888.

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(1) LIPMAN, V.D.: "Local Government Areas 1834-1945."  
Oxford 1949 PP.251-331.

See also the part contributed by the same author in  
"Essays on Local Government," Edited by Wilson, C.H.  
Oxford, 1948



Vital economic and demographic changes, however, took place since 1780. Industrial centres and urban concentrations grew up together with a demographic migration to the north of England. Between 1880 and 1930 the countryside was heavily depopulated. At the present time, there is a drift of industry and population to the south.(1)

France suffers from similar problems. Its "departments," which go back to the French Revolution, and its "communes" are deemed too small for modern conditions.

In U.S.A. the subordinate units date back to the 18th century.

In present day conditions the small unit is confronted with a dilemma. The horns of the dilemma are:

- 1 - Increasing the tax burden on those already paying taxes. This leads to further inequities especially in unitary countries (e.g. England) where the local units rely on one source or a restricted range of local levies
- 2 - Resorting to local borrowing. <sup>this is an alternative.</sup> However, there are economic and legal limitations. The conditions of local debts are less favourable and rates of interest higher. The borrowing locality might have to resort to certain channels as in England or to observe rigid limits as in

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(1) Finer, Herman: "English Local Government."  
London, 1950. PP.57 - 86

the U.S.A. The latter case can even be more unfavourable to local finances. Assessed valuation as a basis for debt limits in the U.S.A. (1) is not only unconnected with capacity to finance debt, but is also perversely elastic: in depression, assessments may decrease thus bringing down debt limits at the very time that spending should be expanded. Moreover, local borrowing may embarrass local finances with high overhead costs.

3 - Seeking subsidies from higher tiers or the central government to supplement their revenue. If the grants are conditional they bear the seeds of local government debility.

4 - Transferring local responsibilities to higher tiers of government or to the central government. Local communities thus lose their importance.

5 - Curtailing the local social and welfare services. Clearly these measures are reactionary, unpopular and liable to be resisted.

6 - <sup>The</sup> ~~Having~~ a high per capita cost of service: This stems from the fact that a small local unit may be below the "optimum local service unit" (for a specific service). This concept is different from that of "per capita expenditures" which decrease the smaller <sup>the</sup> population since limited localities generally assume less services and have less functions. (2)

(1) The limits vary from state to state and slightly between localities of the same state. The range of variation is from one-fifth to one per cent (Georgia's subdivisions) to 40% (Nebraska school districts).

(2) Hansen and Perloff: op.cit. PP.70 -74

## V. THE NEED FOR WIDER AREAS.

A revision of outmoded boundaries is most needed in many countries. The larger areas can have more taxable resources. They can achieve economies in money and manpower as they will be able to resort to modern technique of planning, budgeting or purchasing, and to employ specialists without undue rise in the tax burden or waste of experience since the "population catchment" area of the services will be more suitable. A material reduction in fiscal inequities and inequalities in service levels will ensue. Moreover, the widening of the local units reduces fringe questions, mitigates overlapping, promotes uniformity in administration and fosters co-operation and co-ordination. The facts were ably and clearly put by Mrs. Hicks, "The progress of public investment and the economical operation of trading services would also be facilitated by the wider jurisdiction and greater borrowing powers of semi-regional councils. And for cyclical policy the possibility of securing the co-operation of a few large areas might well make all the difference in the speed and unanimity of changes in the temp of investment."

Various devices can be envisaged in order to cope with the problem of small areas. They can be set out briefly in the following points: (2)

- 1 - Redrawing of the boundaries.
- 2 - The creation of regional boards to assume local services on a wider basis
- 3 - The extension of central administration of local Taxes, the yields being either handed over to, or shared with, the subordinate units. Standardisation of services

(2) State-Local Relations: Report of the Committee on State Local Relations. The Council of State Governments, 1946

control and supervision in some cases would militate in favour of efficiency and lower costs. (more will be said of this point later).

4 - Intergovernmental functional arrangements. Two or more localities can co-operate through optional arrangements, conclusion of contracts or other methods.

All these devices tend to widen the area of local units. They are not however easy to apply as many obstacles are on the way. They are the local loyalties to old boundaries, the vested interests of a local officialdom and the local economic interests which can be summarised as "local pressure groups." It goes without saying that some units will be reluctant to co-operate if they stand to lose.

These attempts towards co-ordination and inter-local collaboration are reflected in unitary and federal countries alike.

In England, various Parliamentary Acts achieved:

- 1 - Co-operation on joint bodies: e.g. Town and Country Planning Act, 1932 - Public Health Act, 1936
- 2 - Appointment of nominees of county district councils on committees or sub-committees of county councils: e.g. Local Government Act, 1929 - Fire Services Act, 1947.
- 3 - Co-ordination by county council of work of county district councils: e.g. Small Holdings and Allotments Act 1908.  
Local Government Act 1929 - Local Government Act, 1933.
- 4 - Financial Assistance from county to county district councils: e.g. Local Government Act, 1933 - Housing



Act, 1936 - Public Health Act, 1936 - Rural Water Supplied and Sewerage Act, 1944 - Housing (Financial and Miscellaneous Provisions) Act, 1946

- 5 - Transfer of functions performed by lower units to higher units: Sometimes the powers of county councils were enlarged, sometimes there was outright centralisation. The latter trend can be illustrated by the Trunk Roads Act, 1946, the National Health Service Act, 1946, the National Assistance Act, 1948, and the various Acts nationalising certain industries. The Local Government Act, 1948, handing assessment and valuation to the Inland Revenue, responds to the same tendency.

The Local Government Boundary Commission, in its Report for 1947, was aware of the demerits of small areas. It makes a significant statement: (1)

"We do not think that an authority of a smaller size than 20,000 possesses sufficient population or resources to secure a reasonable standard for all the major services, and we have been greatly impressed with the higher standard we have found amongst those counties and county boroughs fortunate enough to possess at least this population."

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(1) Report of the Local Government Boundary Commission, For the Year 1947.

H.M.S.O. London, 1948. P.26

See also COLE, G.D.H: "The Local Government Boundary Commission's Report: A Comment."

Public Administration, Spring 1948. P.138

The Commission sets a rational relation between local population and responsibilities. However, by assuming that one million is the maximum for proper local government, it rejects regionalism.

The recommendations the Commission made are an attempt toward rationalisation and co-ordination. It proposes reforms on the following lines:-

1 - Counties: The two-tier counties are to be based on the old ones with, eventually, some modifications, and containing a population from 200,000 to 1,000,000.

One tier counties were also proposed. They are large cities or towns with populations from 200,000 to 500,000

2 - County Boroughs: To be composed of middle-sized towns of 60,000 to 200,000. They are second-tier authorities, looking to the counties for certain services such as police and fire, but they also enjoy important autonomous functions mainly education, health, care of old and disabled and parts of town and country planning and highways. (1)

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(1) The Commission, in fact, thought that the present allocation of local services no more justifies the existence of only two categories of boroughs; all-purpose (county boroughs) and minor purpose ones. It finds place for a most-purpose authority. SEE ALSO

BROWNING.N.F.E.: "The Boundary Commission. Notes on the problems associated with the areas and functions of District Councils within a two tier system of local government." Public Administration. Spring, 1948. P.37

3. County Districts. They would cover non-county boroughs, urban and rural districts. They are to act as second-tier authorities eventually performing functions delegated by county councils.

Other reforms, sometimes more far-reaching, are also promoted regarding areas and local finances.

Professor Cole, who may be mentioned in this connection, proposes a re-classification into Regional Planning Authorities, comprising a county ~~on~~ more (including county boroughs). Major Local Authorities, Middling Local Authorities and smaller local authorities. <sup>(2)</sup>

Besides the local rates, Professor Cole advocates a regional income tax to be based on some wider areas than the regions; named Divisions (North-West, Northern, Midland, Western, South East). The Divisional Income Tax, administered from the centre, is to be apportioned among the regions in the Division (the regions are also to obtain grants).

- (1) COLE, G.D.H. "Local and Regional Government."  
London, 1947. PP.223 - 231

For Regionalism. See also:

Regional Government (Fabian Research Series No.63).

- (2) <sup>In the writer's opinion,</sup> ~~if~~ some present urban districts and boroughs are so poor as not to be able to undertake such services as education, health and welfare, others are financially fit and should not be given <sup>equal</sup> similar status. Examples of the former are Godmanchester, Amblescote, Sawbridgeworth; of the latter, Cambridge, Ealing, Chesterfield and the Medway towns.

In the case of France, it is worthy of note that the dissatisfaction with the problem of administrative areas found expression in the adoption, after defeat, of a system of regional administration which can be viewed as an extension of the centralist prefectorial system to wider areas.(1)

In federal countries, economists are also aware of the problems of inadequate resources, overlapping and fiscal inequities and inequalities posed by the existence of multiple small units.

In the U.S.A. Professor Anderson counted 165,00

- (1) PANTER-BRICK, Keith: "French Regional Administration"

Public Administration (The journal of the Institute of Public Administration).

Autumn, 1951 P.245

CHAPMAN, Brian: A Development in French Regional Administration."

Public Administration, Winter 1950

LIPMAN, V.D. "Recent Trends in French Local Administration."

Public Administration, Spring, 1947.



localities in 1942 (1). The Bureau of the Census counted 155,067.(2) Some states contain an excessive number of localities such as Illinois with 15,854 and Kansas with 11,115. Efforts to foster combination and co-operation are not spared. In fact a certain decrease in the number of areas is noticeable over the decade 1930-1940 as shown by the following table.

U.S.A.  
Decrease in the Number of Local Units (3)

Kind of Unit	1930-33	1941	Decrease	Percentage decrease
Counties	3,053	3,050	3	0.1
Municipalities	16,366	16,262	104	0.6
Townships and Towns	20,262	18,998	1,264	6.2
School Districts	127,108	118,308	8,800	6.9
Special Districts	8,580	8,382	198	2.3
	<u>175,369</u>	<u>165,000</u>	<u>10,369</u>	<u>5.9</u>

- (1) ANDERSON, William: "The Units of Government in the United States."

Public Administration Service, Chicago, 1942. P2

- (2) BUREAU OF THE CENSUS: "Governmental Units in the United States, 1942."

Washington, 1944. P.1.

- (3) ANDERSON, W. cit. 1945, Revised Edition. P2

See also in connection with the problem of areas in the U.S.A

GRAVES, W. Brooke, "Readjusting Governmental Areas and Functions."

The Annals of the American Academy of Political and Social Science:  
Intergovernmental Fiscal Relations in the United States. Philadelphia, January 1940

ROUTT, Garland C. "Interstate Compacts and Administrative Co-Operation."  
The Annals. January, 1940

Professor Leland proposes the suppression of townships, school districts, road districts, sewer districts, mosquito and pest abatement districts; he finds that "This type of financial gerrymandering has led to extravagant support of functions in some districts while <sup>in</sup> others there was a lack of financial resources." (1)

Similar proposals have been advanced by many other observers and reached by several committees.(2)

In Canada, the boundaries of local authorities, in the <sup>s</sup> eastern provinces, have not been subject to adequate revision <sup>for</sup> since more than a hundred years ~~ago~~. The more recent local boundaries in Western Canada, are equally unsatisfactory in present economic and social conditions (3)

- (1) LELAND, Simeon E; "The Relations of Federal, State and Local Finance." in National Tax Association, Proceedings, October 1930 Columbia, 1931 P.98
- (2) Report of the Joint Legislative Committee on Economy and Taxtion." Ohio, 1926 P.249 Also; The Tax Policy League: "The Extravagant Hinterland of Government." in Viewpoints on Public Finance Edited by Groves, Harold. New York, 1947 P.580
- (3) CALLARD, K.; "The Present System of Local Government in Canada: Some Problems of Status, Area, Population and Resources." The Canadian journal of Economics and Political Science, May, 1951 P.204

It is appropriate to reproduce, here, the comment of Prof. Callard of McGill University (Montreal), on Canadian local government units: (1)

"In Canada provincial authority in local government has led, not to intelligent experimentation and adaptation to local needs, but rather to an immense confusion of units and powers and functions and finances; this is so great that it is almost impossible to understand the entire ramifications of the system of any single province. Individual aspects impinge upon the public: the burden of taxes, the weakness of particular services, each in relation to the particular municipality; accordingly remedies when sought are ad hoc, concentrating often upon the symptom not the cause. Organised criticism of the system is next to impossible for few can understand how it works." (2)

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(1) The Canadian citizen is subject to three main authorities; federal, provincial and municipal. A fourth tier exists when the province uses the "county" as a unit. Other authorities enter into play, e.g. the school districts.

(2) Callard, K. : op. cit. P.206.

## SECTION II

### LIMITATIONS TO LOCAL TAXATION

#### I. LOCAL PROPERTY TAXATION

The local taxation of property, whether based on rental value or capital value, is inherently inelastic. It fails to keep pace with the increasing local responsibilities and price inflation.

We may discern economic and legal limitations.

#### I. THE ECONOMIC LIMITATIONS

##### Lack of Direct Connection with Income:

Some taxes are especially lucrative namely those directly based on income, or those levied on consumption. The property taxes, imposed on the local level, by failing to respond to income increases, lack elasticity. The relation of property tax yield to income may even decline especially when the incidence is on the occupier.

In England and Wales the local rates represented more than 4 per cent of national income in 1938 and less



than 3 per cent in 1950. While the national taxes increased 327 per cent over the period 1950 - 1938, the local rates increased by only 60 per cent. (1)

The lack of flexibility of local property taxation is particularly felt in the case of monotaxing localities which cannot resort to other forms of taxation as in Britain. The pluritaxing capacity of subordinate units in other countries, especially federal, acts as a counterpoise. In the U.S.A., the states have a diversified tax system and could leave the property tax to their subdivisions. (2) The latter, mostly depending on property taxation, can share various taxes with the states, notably gasoline, liquor, general sales and public utility taxes. They also share the states income and inheritance taxes to a lesser extent.

Stability is claimed to be a merit of local property taxation.(3) It is contended that the smaller the unit the more important should be the element of short run stability hence the more stable should be its revenue, and the wider the unit the more elastic should be its

- (1) CHESTER, D.N. : "Local Finance." in  
Lloyds Bank Review, July, 1951 P.34
- (2) The only states which still rely heavily on property taxes are Minnesota, Nevada and Nebraska.
- (3) HICKS, J.R. - HICKS, U.K. - LESER, C.E. : "The Problem of Valuation For Rating" Occasional Papers VII Cambridge, 1944 PP.6 - 11

taxes which can serve for fiscal policy purposes. (1)

In depression, the local budgets would be able to meet overhead costs and important needs without resort to borrowing or subsidies which undermine local government

and may not be easily obtainable. *The cycle-sensitiveness of the taxes is acceptable parts of the country tend to offset each other. on the central level where gains and losses in different*

In the writer's view, the revenue stability feature, claimed as a merit, is not easy to uphold in modern economic conditions of controlled economy and full employment policies which ushered in two important changes, namely; the more limited scope for economic convulsions and the need for large funds to launch the national plan on the central as well as on the local levels. Thus the stability feature seems more of an impediment than of a help and can be rather described as stickiness. (2)

However, inspite of the inherent inequity of property taxation and inspite of the economic conflicts it may bring about, especially within the framework of a controlled economy, the property tax seems to be inevitable as a source of local revenue.

(1) HANSEN and PERLOFF: "State and Local Finance in The National Economy." New York 1944. P.251

(2) In fact, the stability of revenue of property taxation may be shaken, as in the U.S.A., by such factors as speculative purchases and sales or speculative over-building affecting property values.

ENGLAND AND WALESREVENUE ACCOUNTS of LOCAL AUTHORITIES.(1)

Year ending 31st March	Total Receipts (from rates, grants and all other sources) (a)	Rates
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	L.M.	Percentages
1914	105	68
1920	175	61
1930	313	50
1940	445	45
1949	686	41

(a) The revenue does not include trading services, with the exception of profits transferred to or losses charged against the General Rate Fund

(1) CHESTER, D.N. op.cit.

U.S.A.1. Property Taxes as % Percentage of Total State and Local Tax Revenue, 1915 - 1940 (1)

Year	Property Tax as percentage of all Local Taxes	Year	Property Tax as percentage of all Local Taxes
1915	85.5	1939	56.3
1925	77.0	1940	55.0
1929	71.9		
1935	65.2		

N.B. The total state and local tax collections exclude unemployment compensation taxes. The property taxes here are composed of those levied by the local governments and the few general and specific property taxes levied by the states.

2 - Local Tax Collections as Percentage of National Income.(1)  
1932 - 1941

Year	National Income	Percentage of local taxes	Year	National Income	Percentage of local taxes
	Bills.			Bills.	
1932	\$39.9	11.7	1938	\$ 64.1	6.8
1933	\$42.3	10.0	1939	\$ 70.8	6.1
1934	\$49.3	8.4	1940	\$ 77.2	5.7
1935	\$55.7	7.7	1941	\$ 94.5	5.6
1936	\$64.9	6.6			
1937	\$71.5	6.1			

N.B. Local Taxes, over this period, are composed of more than 90 per cent in property taxes.

(1) "Federal, State and Local Government Fiscal Relations"  
op. cit. P.333 & P.352.



## VALUATION INADEQUACY

Whether the local property tax is based on annual rental value as in Britain, or on "fair" market value as in U.S.A., an assessment of the property is required. Valuation must be undertaken often otherwise it loses touch with economic conditions and exerts a restrictive effect on local revenue by causing a potential loss in tax yields given the same rate of tax. The upswing in values, induced by property scarcities, in a dynamic ~~society~~ <sup>economic</sup> society, is neutralised. The conventional rent does not reflect true rent. Market value may fail to reflect either the current year's income or the capitalised value of future income (1)

Clearly the tax rates can be raised on the basis of the outdated assessments in order to secure more revenue. However, the lack of revision is of ~~peculiar~~ <sup>particular</sup> importance in countries where limits are fixed for local tax rates as in U.S.A. and Egypt.

Assessment, especially when entrusted to local bodies, is not undertaken at frequent intervals because it is <sup>a</sup> technically hard task involving high costs. It is sometimes retarded by emergencies such as war. It is then found more expedient to count on the old valuations

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- (1) In England, there has been no valuation since 1934 in spite of a pre-war attempt. In the U.S.A., real property is assessed at intervals of up to ten years. The annual assessment of personal property is often done on the basis of the preceding year.

It is noticeable that valuations may be directly frozen. In Britain the Rent Restrictions Acts adversely affected the assessments of most houses at pre-war levels.

Valuation tends to lag behind the actual rental or market values (according to the system in application), Economic expansion or the <sup>fall</sup> rise in the value of money increase the financial burden of local governments and call for more revenue through readjustment of assessments. ①

Deliberate under-assessment is a further source of inadequacy. It is resorted to, for different purposes, in unitary and federal countries alike. In Britain, it was used for "new" houses built since 1920. (2) The extent of underassessment, up to 1938, was estimated at 20% and the annual rate rebate at 8 - 9 million pounds which are equivalent to a subsidy. New houses should be assessed at full value and the rebate calculated afterwards, as an optional local measure, for a limited number of years and not as a perpetual privilege. (3) In the writer's view, an overt subsidy may well prove more operative and moreover averts the confusion caused in the technical computation of the tax.

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① While prices nearly trebled since 1939 and expenditure of local authorities, out of rates, increased by about 75%, total rateable value rose by only 10%.  
Revaluation could add something like £100m. to rateable value.

See also next point (Legal Limitations).

In the U.S.A. there is a tendency to underassess new buildings and industrial premises and to freeze the assessments in blighted or old regions where property values are in decline. Systems of property classification, partial (especially for intangibles) or comprehensive, are in application in nearly two-thirds of the states. The aim is to tax different types of property at different proportions of their assessment value. Although this procedure is justifiable on grounds of equity (property is heterogenous) it nonetheless often involves a potential loss of revenue.

The difficulties of valuation are increasingly confining the General Property Tax to fixed property. It was also noticed that property values are declining. The tendency is particularly burdensome in urban communities having extensive responsibilities. Between 1940 - 48, in many cities valuations were not affected. In some others they increased only slightly, e.g. New York from \$16.5 billion to \$17.6 bil., Philadelphia from \$3.3 billion to \$3.4. billion.(1) Hansen and Perloff are right in remarking that, "When we consider the wartime demonstration of our national productive capacity, it is ridiculous to assume that property values must continue to decline." (2)

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- (1) CAMPBELL, Colin: "Are Property Tax Rates Increasing?." The journal of Political Economy, October 1951. P.441  
BIRD, L. Frederick: "The Financial Problems of Cities." in American Economic Review, Papers and Proceedings December, 1941. P.323
- (2) HANSEN and PERLOFF: op.cit. P.276.

## U. S. A.

Assessed Valuation of Local Property (1)

1929 - 38 (Billions of Dollars)

Year	Amount	Year	Amount
1929	167.6	1935	135.4
1930	169.3	1936	136.2
1931	161.3	1937	139.2
1932	150.3	1938	139.3
1933	141.3		
1934	136.6		

N.B. The local property tax here is that levied by localities

Gap Between Property Tax Receipts and Current Expenditures  
For the Ten Largest Cities, 1926 - 1939(2).  
 1926 = 100

Year	Current Expend.	Assessed Valuations	Property Tax Revenue
1926	100	100	100
1930	129	130	116
1933	131	114	102
1936	140	102	112
1938	152	105	125
1939	153	(not available)	122

(1) HANSEN and PERLOFF: op.cit. P.58

(2) "Federal, State and Local Government Fiscal Relations."  
 op. cit. P.405.



It is highly desirable to reach out for an adequate and self-adjusting device for valuation. In England the basis should be the actual free rent. Only individual houses, with abnormal rents, can be excepted. Controlled houses, council houses (which are not fully assessed) and owner-occupied houses should be valued by analogy with free houses instead of the opposite practice. Some keen observers comment that, "A system of valuations based upon free rents has the supreme advantage that it can be relied upon to go on revising itself - to go on bringing itself up to date." (1)

In the U.S.A. there is ample scope for improvements in valuation. The assessment districts should be widened and consolidated. Technical qualifications should be possessed by the assessors who should be appointed and not elected and should be full-time officials.

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(1) HICKS, J.R. - HICKS W. K, and LESER: op cit. P.76

## Mobility of Production Factors

### The stickiness of valuation and its mobility

In conclusion, valuation cannot be left to lower layers of government. It is an inherently central function. From the political standpoint, the local assessors are influenced by the locally elected councils. This is especially true if the assessor is elected and not nominated as in the U.S.A. From the economic viewpoint, valuation involves much expenses and requires full-time professional assistance which may not be available to local bodies.

In England, the attempt towards uniformity of the Rating and Valuation Act of 1925 was not successful. The nomination of county valuation officers was not compulsory and the Central Valuation Committee was an advisory body. In 1948, however, the Local Government Act transferred assessment to the Inland Revenue.

In the U.S.A. it is desirable to hand assessment to higher units, preferably the states (this is sometimes actually the case), or at least to metropolitan or county governments.

### Inter-local cooperation for taxable resources

can, in fact, to some extent reduce any building activities and industries from other areas with the help of lower levies or exemptions, partial or total.

(1) In the case of "apparent" rises in tax rates the effect is psychological.

### Mobility of Production Factors:

The stickiness of valuation and its inability to keep pace with increasing expenditures forces the local authorities to raise the tax rates. Whether this rise is effective or apparent (being based on outmoded valuations), the tax basis is liable to be affected through shifting. (1)

In the case of residential property, if the tax falls on the occupier, the latter is induced to move away from the area in normal times. Local investment in building can be adversely affected if the owners bear the rise in tax rates through shifting or, having to pay the tax (as in some countries), cannot shift it to the occupiers.

If the local property tax burdens industrial hereditaments, local investment may be discouraged especially in cases where fixed property assumes great proportions. Consequently, industry has been partially derated in England and in U.S.A. so many exemptions are granted to some industries especially in the new ones.

Inter-local competition for taxable resources can, in fact, to some extent entice away building activities and industries from other areas with the bait of lower levies or exemptions, partial or total

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(1) In the case of "apparent" rises in tax rates the effect is psychological.

In the writer's view, the favourable treatment reserved to factories and industrial premises can cause much embarrassment to the local authorities if the severance is considerable between residential shifting and industrial shifting. The local bodies would then have to maintain services for local industry (cleaning, electricity, fire-protection, sewerage.,) and also for its day-time citizens while its revenue from property is curtailed. As for intengible property, the attempt to include it in a local property tax is doomed to failure since it is very mobile.

It is noticeable that there may be more scope for inter-local mobility in case the localities are pluri-taxing as some would then prefer to increase the property tax rates while others would prefer raising other local taxes. Thus the door is open for inter-local disparities in the property tax burden.

Disparities can also occur in or between monotaxing authorities (i.e. those relying only on property taxation). For instance, municipalities, which incur many responsibilities may raise the tax burden and thus drive away the residents to peripheral areas with the outcome that the municipal taxable resources are depleted while their liabilities are not diminished. Attempts to consolidate the whole metropolitan area is not an easy matter and can meet with the resistance of the suburban residents on the ground that they do not enjoy direct benefits.



## 2 - LEGAL LIMITATIONS

### Tax Exemptions:

It is surprising that, unlike other taxes, so many limitations restrict the scope of the local property taxes, either in unitary or federal countries. The limitations affect the form of exemptions or tax ceiling of one sort or another.

In England, agricultural hereditaments were completely derated in 1929. Industrial, railways premises, docks and canals were derated by 75 per cent. Professor Chester estimates that the abolition, in England and Wales, of agricultural exemption might add from 25 to 30 million pounds. The abolition of industrial and transportation derating might add from 30 to 35 million pounds (1)

It is noteworthy that other forms of derating, statutory or not, also take place. In the case of the local rates on houses, the gross value is reduced by special percentages (assumed to represent insurance and repairs) before reaching rateable value. There is also the deliberate underassessment of new houses built after the First World War and the impact of rent restrictions on valuations, the gross values being based on controlled rents.

(1) CHESTER, D.N. : op.cit. P.37

It must be noticed that derating of industry, if not compensated by a reduction in national revenue will add to production costs. If derates the cost of derating is borne by the National Exchequer, and is counterbalanced, wholly or substantially, by readjustment of the grants, a <sup>reduction</sup> ~~reversal~~ of the latter ~~for~~ <sup>reduction</sup> will occur take place. Some local authorities will then neither gain or lose eg. seaside resorts, without industries & not receiving grants. Some local authorities, with industries but no grants will gain eg. Manchester, Liverpool, Leeds. Other authorities, with industries, grant-aided, will lose the grants & will have to rely upon themselves.

In the U.S.A., the field of exemptions is too wide. Apart from schools, charitable organisations, agricultural societies, veterans and their organisations, there are homestead exemptions and exemptions to certain industries.

The homestead exemptions are given on all or part of the assessed value or the full and true value (there are generally urban and rural area limitations). Within the same state, the number of table units to which exemptions are applicable varies.

U.S.A.: Examples of Homestead  
Exemptions, Dec.1949 (1)

State	Amount of Exemption	Area Limitation	Taxable units to which exemption is applied
ALABAMA	(First \$2,000 of (assessed value	(Homestead may (not exceed 160 acres)	State
FLORIDA	(First \$5,000 of (assessed value	(Rural, 160 acres. Urban one-half acre )	State and Local
GEORGIA	(First \$2,000 of (assessed value		( State county (and schooldistrict
SOUTH DAKOTA	(Total Value; (limited to \$5000 (for soldier's (bonus tax.	Rural, 160 acres) Urban, 1 acre )	

Exemptions are also provided to certain industries especially the manufacturing realty. Although these exemptions are usually given for temporary periods (average 5 years) and although they are usually limited to new plants or the expansion of existing capacity, the exemption from taxation constitutes a loss of revenue to the underlying authorities (while the burden of public services increase) especially when the exemptions apply to state as well as local taxes instead of applying only to some of the junior authorities

(1) KIMMEL, Lewis: Taxes and Economic Incentives. The Brookings Institution, Washington, 1950 p.172

They are a poor way to achieve an equalization of the tax burden or to cope with the problem of revenues. It is to be noticed that nearly one third of the American states allow various exemptions to manufacturing industries. In 1942, the assessment value of tax-exempt real property amount<sup>ed</sup> to 18 per cent of the total assessment of real estate (\$26 billion against 145 billion). The cities suffer most from homestead exemptions. The latter amounted to 31% of total assessment in the city of De Land (Florida) (1)

It was estimated that the abolition of exemptions (excluding municipally owned property) would cause an increase of \$350 - 500 million annually. This is equivalent to one-sixth of total property tax revenue.(2)

#### Tax Rate Limitations:

Inspite of the restricted tax basis of local property taxes, ceilings are sometimes fixed for the tax rates. If substantial, these limitations can be a serious curb from the revenue point of view.

Tax limits, if uniform all over the country, or a region with its subdivisions, fail to account for the inter-local differences in per capita costs of services and for such differences between rural and urban communities.

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- (1) State - Local Relations: Report Of The Committee on State - Local Relations.

The Council of State Governments, 1946  
PP.99 - 103

- (2) State - Local Relations: op.cit. P.102

They are a poor way to achieve an equalisation of the tax burden or to cope with the problem of revenue deficiency.

In some undeveloped countries where real property is often a criterium of wealth, the limitations may be the outcome of pressure groups in local authorities dominated by the wealthy as was the case in Egypt where the local land tax was limited to a maximum of 11 per cent of the central land tax. In advanced countries this may also be the case, especially in times of depression where the needy localities are tempted to turn to the property tax for more revenue. This was the case with local governments in the U.S.A. in the thirties.

The nature of the limitations can be gleaned from the following considerations.

In England there are no legal limits to the rates except for the limitations to rateable values (derating, under-assessment, the effect of rent restrictions).

In the U.S.A. the problem assumes substantial proportions. Forty states resort to some type of limitation. The writer fully agrees that, "Revision of existing systems of tax limitation is an urgent task facing state and local officials."<sup>1</sup>

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1. State - Local Relations: op. cit., p. 104.



Here are various American devices of legal limitations: (1)

- 1 - overall rate limitations on a specific type of property.
- 2 - maximum rates for general purposes on each type of governemtn unit
- 3 - rate limits based on the purpose of expenditure.
- 4 - special limits for certain local units.

As for the extent of the limits one can find:-

- 1 - a range of rates, for instance when the maximum varies according to assessment value or local population.
- 2 - variable rates to yield a fixed sum per capita.
- 3 - variable rates to yield a fixed aggregate sum
- 4 - rates fixed on the basis of previous year.

The result of such restrictions is less revenue flexibility and sometimes virtually no flexibility as in the case of overall tax limiations when combined with fixed rates for the different local units. The overall property limiations are already very stringent.

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(1) A single state may adopt several types of limitation.  
see - "State - Local Relations." op.cit. PP.103 - 113  
It is noteworthy that the tax limiations were especially adopted in the early thirties as a result of the depression.  
See: Report of the Committee on Property Tax Limitation and Homestead Exemption. in, National Tax Association, Proceedings, 1938.

## U.S.A.

Per Cent Per Capita Changes in  
Local Property Tax Revenue (1)

1932 - 1941

States with No General Limits or Unimportant Special Limits	Percentage Change	State with Overall Tax Limits	Percentage change
Connecticut	10.6	Indiana	- 22.7
Delaware	- 22.8	Michigan	- 21.4
Maine	- 2.1	Nevada	8.3
New Hampshire	20.7	New Mexico	- 50.4
Vermont	35.7	Ohio	- 31.9
		Oklahoma	- 9.7
		Rhode Island	6.4
		Washington	- 25.1
		West Virginia	- 48.4
Arithmetical Average	8.4	Arithmetical Average	- 21.6

- (1) Bureau of the Census : "Financing Federal, State  
 and Local Governments.  
 Washing, 1942

### 3. CENTRAL ECONOMIC POLICY

The central government, which controls the economic background of local taxes, can impair or foster the revenue yielding capacity of these taxes. This is particularly true in modern conditions of planned economy and full employment policies. Clearly monotaxing localities are liable to be more affected than pluri-taxing ones.

A national investment and full employment plan, whether flexible or rigid, may involve rationing of raw materials for investment in durable consumption goods so as to foster ~~individual~~<sup>industrial</sup> development and the production of capital equipment. This may deprive the local units or at least some of them, from an increase in fixed property proportionate to the increase incosts of service due to the inflationary tendencies which often accompany national programmes concentrating on heavy industries to the detriment of consumption industries. The natural increase in population calls for increasing expenditure for which revenue is not forthcoming. The national plan may involve such changes in industrial location and direction of labour as to enhance hardships and distortions in the local taxable resources. These effects may obtain even more strongly, in hot-war or cold-war national planning.

In a peace plan, the central authorities may launch unto social policies and housing schemes, as in post-war

4 - PSYCHOLOGICAL EFFECTS

This is a set of factors which the writer suggests reconstruction periods or in under-developed countries. Government houses let at low rents and low taxes, or free from taxation, the deliberate underassessment of small houses or the new ones built by the authorities all affect, directly or indirectly, (1) the scope for local revenue from the taxation of property. Moreover the control of rent and the restriction of dealings and speculations in real property constitute hindrances to adequate assessments.

It should not be inferred that local bodies are free from "central" impact in a free or unplanned economy. Inconsiderate exploitation of natural resources, unwise use of land and buildings and other wastes can play havoc with the basis of local property taxes. This actually occurred in the U.S.A. in the 'twenties and 'thirties especially in regions in Wisconsin, Minnesota and Michigan. An enlightening illustration is afforded by Forest County (Wisconsin) where the tax base was reduced by 53 per cent in only ten years, 1927 - 1936.(2)

rates in the U.S.A., Professor Campbell reaches the

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(1) For instance, through affecting private investments in an adverse way.

(2) Hansen and Perloff: op.cit. P.101.

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(1) CAMPBELL, Colin: "Are Property Tax Rates Increasing?" The Journal of Political Economy, October 1951, p. 441.



#### 4 - PSYCHOLOGICAL EFFECTS

This is a set of factors which the writer *regards* ~~qualifies~~ as psychological because they are not technical or strict limitations to the local taxation of property.

We may set out, briefly, the following points.

1. Fictive and True Tax Rates: As assessment values often lag behind changes in economic conditions or are deliberately reduced (underassessment), the effective tax rates will be lower than the nominal tax rates. An illustration is afforded by a period of inflation. The local units, having to match increasing expenses, may then raise the tax rates. Since the rates are based on out-dated valuations, the true rates may remain unchanged or undergo only a slight increase. However, there prevails a general, unjustifiable impression that the tax burden has become heavier. In a very able study about the property tax rates in the U.S.A., Professor Campbell reaches the significant conclusion that, "Property tax rates, when expressed as a percentage of the true value of property, were not higher in 1949 than in the 1920's. The decline in true rates during the 1940's indicates that localities were using their property tax resources less intensively."<sup>(1)</sup>

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(1) CAMPBELL, Colin: "Are Property Tax Rates Increasing?"  
The Journal of Political Economy. October 1951. P. 441.

The Form of the tax rates: Some psychological effect ~~acting as a deterrent~~, may be produced by a tax expressed in such a way as to give to the mass of the taxpayers the impression that they are being asked too much or are being "squeezed." This is the case of England where the rate poundage is expressed in so much per pound but of rateable value and not of personal income. (1)

The Benefit Principle: People, paying local taxes, generally expect some direct advantage for what they are paying. In case they do not get such benefits they believe that they pay more than is necessary and a wave of recriminations is ushered in.

The Average Rates In the Pound  
England & Wales, 1954-55 (2)

County Boroughs	23s. 2d.
Metropolitan Bor.	20 7
Non-County Bor.	23 9
Urban Districts	23 11
Rural Districts	21 9

(1) CHESTER, D.N. : op cit. P.38.

(2) Returns issued by the Institute Of Municipal Treasurers & Accountants.

## II. LOCAL INCOME TAXATION

It should not be thought that regional income taxation is a panacea for the cure of all financial maladies and embarrassments of local bodies. Besides the various types of fiscal inequities and overlapping mentioned above, there are substantial limits to the yielding capacity of incomes tax (personal or business) when levied on the local level

### 1. Economic Limitations:

In modern economic conditions of full employment economics, hot-war economics and cold-war economics, there is no ground ~~for~~ believing that national governments will ever abandon the income tax which Keynesian analysis and modern fiscal policy revealed as a potent tool of economic and social policy. The federal governments have already invaded this field which was up to the Second World War constitutionally reserved to their subordinate units. The federal governments either used the income tax concurrently with their subdivisions as in U.S.A. or took it over altogether as in Australia and Canada in World War II. The encroachment was either based on constitutional amendment as in U.S.A. in 1913 or, more easily, on reciprocal agreements as in Australia and Canada.

Once the centralisation of income taxation becomes an accomplished fact, a definite economic limit is

automatically set up to local income taxation. The *Total* tax on individuals and business cannot in fact exceed 100 per cent, otherwise it amounts to confiscation and one would prefer to live on <sup>one's</sup> his capital (1).

The problem is ~~now~~ made even more serious since the high level of expenditures, induced by welfare and war economics, requires a high level of income taxation, and subsequently very high central tax rates.

If the central government has a right of pre-emption in taxation as is the case in unitary countries, the local units will be deterred from levying more than a low range of rates. In some federations before the last war (Australia, Canada) the subordinate units had the right of pre-exption when the scope for income taxation was limited. Now this is most <sup>un</sup>likely to occur whether in old or newly formed federations.

Consequently, the central taxing authorities have the lion's share while the lower taxing jurisdictions are left with only the residue.

It is noticeable that the principle of deductibility allows the central government, especially in federations, to wield the income tax as an economic instrument without much regard to the present level, or possible changes in the level of, local income taxes.

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(1) HICKS, J.R. - HICKS, U.K. and LESER: op.cit. P.11.



## 2. FISCO-legal Limitations:

There are sometimes constitutional, legal and judicial barriers to the local taxation of property especially in federal countries. This is the case in some American states notably Illinois, Michigan and Indiana. The income tax passed by Illinois in 1932 was declared unconstitutional on the ground that "income is property" and property must be assessed at a "just and uniform rate." The amendment of that state's constitution is difficult.

Moreover, the base of local income taxes is often narrow. It may be confined to certain elements of income. Various items may be excluded. The exemption limits and allowances are generally high and the progression mild. It is noticeable that the smaller the taxing locality the more restricted is the scope for progression.

Furthermore, the taxation of income, on the local level, involves loopholes and offers numerous possibilities of evasion, legal or illegal. The untaxed elements of income are liable to be a resort for taxed elements.

## 3. Mobility of Production Factors

The possibility of efflux and influx of resources sets clear limits to the revenue yielding capacity <sup>to of</sup> local income taxes.

Two aspects may be outlined briefly:

(a) Inter-Local Disparities in Fiscal Burden:

There is probably more scope for inter-local differences in the field of income taxes than in the case of other taxes. The provisions regarding the scope of the tax, deductions, allowances, rates and also high costs of administration and compliance all open the door to disparities in the tax burden.

The local residents and business<sup>es</sup> tend to move away from heavily taxed areas. Overlapping and multiplicity, which may be more serious in particular areas owing to a higher proportion of cosmopolitan incomes, are conducive to similar consequences, especially when resulting in a burden approximating or exceeding 100 per cent of income.

The efflux of income taxable resources ~~works~~ <sup>wreaks</sup> havoc not only with local revenue (through re-action on other taxes) but also with local expenditure. The outgoing industries and high income-receivers leave in their wake overhead costs and other irreducible liabilities which have to be matched, especially if the locality is left with low income receivers whose mobility is generally low.

and "pulling themselves up."

Past experience in some countries can be invoked in support of these limitations. In Sweden, "After twenty years' experience it was found that it had mainly been used by the wealthy authorities, who had little need for further revenue." (1)

(b) Inter-Local Competition: The various lower taxing units may compete to attract wealthy residents, industry or specific industries with the bait of lower rates or higher exemptions and allowances. The production factors are enticed away from one locality to another thus causing a loss to other localities not only of the income tax base but of property tax base as well

*The absence of heterogeneity*  
Uniformity in local taxation is beneficial from the standpoint of productivity. It permits the proper taxation of resources which, otherwise, would have to be coddled for fear of their flight

#### 4. Debtor Localities.

The inter-local disparities in per capita wealth and income were already pointed out. The under-endowed areas will be unable to manipulate the income tax in any substantial degree. Moreover, much of their meagre income is paid over their borders to creditor localities. A local income tax thus tends to be adopted by, and be lucrative to, only wealthy localities. The efforts in favour of taxation, according to domicile would aggravate the problem, <sup>unless compensation is given to the debtor local areas.</sup> True, the wealthy localities often shoulder more responsibilities but the poorer ones are deterred from "pulling themselves up."

Past experience in some countries can be invoked in support of these limitations <sup>to local income taxation</sup>. In Sweden, "After twenty years" experience it was found that it had mainly been used by the wealthy authorities, who had little need for further revenue." (1)

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(1) HICKS, J.R. - HICKS, U.K. and LESER: op.cit. P.10

## 5. Central Control Of Economic Basis

More than in the case of property taxation, the economic background of local income taxes is not within the control of local authorities, especially in an era of controlled economy.

In an interventionist economy, as ~~opposed~~ <sup>distinct from</sup> to a planned economy, the central government's measurers are often not harmonious. They are not based on an overview of the national economy as a whole and are often interwoven with contradictions. Pressure groups may imbue central economic measures with bias. The result is that some branches may be fostered to the detriment of others. The prices of certain groups of production factors may be enhanced relatively to others. Certain home industries may be harmed by customs duties favouring a class of importers. Other industries may be adversely affected by the encouragement of particular exports. Clearly such measurers, sometimes conflicting, sometimes reflecting sectional interests, have varying implications on local budgets according to the pattern of economic activities prevailing within the boundaries of the different localities. The effects may be beneficial or baneful.

Economic planning, the offspring of interventionism, intensified the impact of central economic behaviour on local finances. Planning for whatever



purpose (consumption, industrial equipment, was production) aims at rationalising the use of the nation's resources and achieving full employment. Keynesian economics and concerted fiscal policies imply the manipulation of basic factors on the central level such as investment, savings, consumption, national income, employment, in sum the multiplier and acceleration principles.

In so far as economic planning increases taxable resources, reduces distress and irons out fluctuations, it exerts a beneficial effect on local finances. However, the effect is detrimental as long as planning fosters centralisation of fiscal powers, <sup>or</sup> circumscribes local taxable resources ~~and saddles the local bodies with new responsibilities~~. Local outgo then fails to match local income.

#### 6. Administrative and Compliance Costs.

Both tend to be high in the case of multiplex and small taxing jurisdictions and in the case of a messy and wild conglomeration of local imposts as is often the case in a federal polity. (1)

Various reasons account for the high costs of administration. The scope for local taxation is smaller than in central taxation so that a given amount of

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(1) SHOUP, Carl - Blough, Roy and Newcomer, Mabel, in "Facing The Tax Problem." Twentieth Century Fund New York, 1937 PP.336 - 342

expenses yields less revenue. The ratio of expenses to collections is also ~~put up~~<sup>accentuated</sup> by overlapping, multiplicity and evasion. It goes without saying that local authorities often lack efficiency in technique or accounting practices so necessary for an "economical" tax.

The latter classical canon of taxation can be similarly infringed by high compliance costs. This is most likely to be the case in the several-deck taxation of personal and business income and the diversity of taxes within the same locality.

In the U.S.A. attempts were made, notably by Professor Haig (1) and Professor Martin (2) to compute the compliance costs of state income taxes. Samples of corporations were taken. The results point to a high level of costs. According to Professor Martin, in a recent study, the compliance costs for state corporation and individual income taxes were 3.2 cents per \$1.00 but 2.5 cents on the federal level.

In Canada, the high costs of administration were also underlined by the Royal Commission on Dominion-Provincial Relations.

It is necessary to reduce the dual tax administrative and compliance costs. The remedy lies in the delegation of administration to higher authorities or, at least, joint administration and integrated collaboration.

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- (1) Haig, Robert Murray: "The Cost to Business Concerns of Compliance With Tax Laws." The Management Review, November, 1935. P.323
  - (2) Martin, James.W.: "Costs of Tax Administration: Examples of Compliance Expenses." Bulletin of the National Tax Association No.7 April, 1944 PP.194 - 205

### III Local Outlay Taxes

The subordinate government units in unitary and federal countries are deterred from levying customs duties. However, they may resort to other forms of indirect levies such as excise duties and sales taxes.

Sales taxes deserve special attention on account of their increasing importance as outlined above (1)

When imposed on the central level, sales taxes are very lucrative. The few limitations, then, seem to be their irritating or unpopular character when exaggerated (by reason of their regressivity) and the inter-relations between competing and complementary products.

When levied on the local level, the sales taxes have, in addition to the forementioned limitations, other limitations of ~~more~~ serious character which do not prevail in the case of central taxation.

#### 1. Out-of- Locality Purchases :

The local outlay taxes, being borne by the local consumers in the long run, may induce the local residents to make their purchases across the boundaries in neighbouring localities where there might be low or no sales taxes. Buying outside the locality is much easier than residential or industrial shifting.

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(1) The Sales taxes are either "general" or "specific" (i.e. on certain commodities). In the former case, they may be levied at different stages: production, retailing or wholesale trade.

Clearly, the minor taxing authorities, situated on the fringe of provinces or states in federal countries, are handicapped in view of the greater ~~ease~~ *ease* of purchasing ~~of~~ tax-exempt commodities from adjoining areas.

The taxing locality can take one of two courses in an effort to project <sup>t</sup>he revenue productivity of its taxes. It may confine the levy to commodities not easily purchasable "outside" its borders. This however limits the yielding capacity and implies discrimination against certain local concerns.

Alternatively, the taxing locality may have to impose a compensatory tax on commodities coming in from other local areas. Such imposts, akin to customs duties, cannot be remunerative. They are merely protective and serve the purpose of preserving the revenue productivity of the local consumption taxes.

The local sales taxes are to be fruitless, only if adopted by wide regions, within the country, (counties, departments, states, provinces) or large urban centres.

### 3. Mobility of Production Factors:

When the local outlet taxes are shifted to the consumers in higher prices there are severe inter-local disparities in costs of living. The outcome can be the emigration of the local residents to areas



## 2. Urban and Rural Communities

The productivity of the sales taxes is high, the higher is the volume of transactions generally and that of necessities or necessary luxuries in particular. In rural communities, the population is generally sparse and the farmers consume directly what they produce. In urban communities, there are ~~likely to be~~ large concentrations of population, larger volumes of consumption and higher standards. Clearly, in the latter case the sales taxes will be more productive.

Consequently, there is not much scope for sales taxes in agricultural areas or areas with unsettled nomadic populations (e.g. the Middle East.) Moreover the low living standards prevailing there militate against such imposts as their progressive impact will be more readily felt.

The local sales taxes seem to be fruitful only if adopted by wide regions, within the country, (counties, departments, states, provinces) or large urban centres.

## 3. Mobility of Production Factors:

When the local outlay taxes are shifted to the consumers in higher prices there may emerge inter-local disparities in costs of living. The outcome can be the emigration of the local residents to areas

with lower living costs and the subsequent weakening of the tax basis.

Local industrial and business concerns hit by the tax, may not be able to shift it, or part of it, as in the short run or in the case of new businesses or non-inter-area concerns, or when the tax rates are so high as to affect total sales. In this case, the following results may occur:

- (a) The production of lower quality goods to meet the requirements of the taxing locality and high quality goods for other localities, thus adding to the unattractiveness of inside purchases.
- (b) A decrease of demand for the taxed products, causing a decrease in production and rise in local per unit costs. The subsequent reduction in local industrial activity, impoverishes the area and undermines its fiscal capacity.
- (c) The shifting of the local industries to other areas, less taxed.

In short, the local outlay taxes result in quantitative and qualitative distortions of production and marketing channels in an attempt to by-pass or mitigate the impact of high local levies.

In the writer's judgement, the retail sales taxes seem more appropriate to local taxation, Retailing is, in fact, less mobile than manufacturing or wholesaling since it must be close to consumers. Moreover, the broad base of these taxes make possible low rates and large revenue with comparatively less menace of diverting local business.

#### 4. Costs of Administration and Compliance

These may prove high in the case of modern sales taxes, general or specific. This is contrary to the general view. The writer quite agrees with Professor Haig and Professor Shoup, that "...the sales tax seems to have gained a wholly unwarranted reputation for simplicity and ease of administration." (1)

When used on the local level these taxes are likely to involve even more trouble and expenses.

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- (1) HAIG, R.M. and SHOUP, C.: "The Sales Tax in The American States." New York, 1934.

PP.105 - 106

Tobacco  
 Alcoholic Beverage  
 Motor Vehicle  
 Sales  
 Manufacturers' and  
 Retailers' Excess  
 Taxes

(2) Compiled From:

"Federal, State and Local Government Fiscal Relations,"  
 op.cit. P.207 and P.303

This is due to the complex structure of the taxes and to the various problems outlined above, notably the out-of-boundary purchases and the mobility of the production factors which are causative of loss and evasion. Much vigilance, caution and efficiency are needed. The central government possesses these qualities and has no boundary problems. Furthermore, it can lay the tax at such point of the distributive process as to secure the most economical administration.

The lower taxing units can realise reductions in administrative costs if they exempt small sales. However, by doing so they run the risk of curtailing revenue.

The best course seems to be a combined central-local administration, especially in the case of overlapping taxes, and co-operation in other cases.

#### U. S. A.

#### Comparative Average Cost of Collecting \$100 of Outlay Taxes, 1941 (1)

Tax	State <del>\$</del>	Federal <del>\$</del>
Tobacco	1.40 (not all)	.18
Alcoholic Beverage	3.00	1.66
Motor-Vehicle	8.00	
Sales	2.00	
Manufacturer's and Retailers' Excise Taxes.		.10

(1) Compiled from:

"Federal, State and Local Government Fiscal Relations."  
op.cit. P.307 and P.309



## C H A P T E R   F O U R

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### INTERGOVERNMENTAL

#### FISCAL POLICY

#### CONFLICTS

In an intergovernmental system, the various levels of government are all engaged in the same economic activity. The central government is the primary provider of public services, and the local government is the primary provider of public services. The central government is the primary provider of public services, and the local government is the primary provider of public services.

At the stage of economic planning, economic development, and economic growth, the central government is the primary provider of public services, and the local government is the primary provider of public services. The central government is the primary provider of public services, and the local government is the primary provider of public services. The central government is the primary provider of public services, and the local government is the primary provider of public services.

## P R E L U D E

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I N a free economy, the consumer reigns supreme. The price mechanism is the regulator of the economy. The factors of production move to where their marginal productivity is higher.

Under such conditions, the senior as well as the junior authorities play a minor role in the National economy. Central and local fiscal powers are restricted. There is little scope for economic or fiscal friction between authorities and individuals, between junior authorities inter se or between the various tiers of authority.

In an interventionist state, various economic measures make their appearance in certain sectors and the way is paved for the ~~primary~~ precursory signs ~~augur~~ of central-local disharmony.

At the stage of economic planning, economic measures evolve into coherent policies, contrived in such a way as to achieve nation-wide objectives through a single-minded approach. Co-ordination and integration may reach such a point as to produce a comprehensive national plan clearly delineated and well interwoven. Central-local policy contradictions thus grow greater and may even assume substantial proportions.

How the central government came to play a major part in the national economy can be briefly sketched. The New economics, based on income-expenditure analysis places major emphasis on effective demand. Investment and savings are equilibrated by the income mechanism. However, savings are not necessarily offset by investment at full employment level. The private propensity to invest is contingent, being dependent on the relation between the marginal efficiency of capital and the monetary rate of interest. The consumption function is not susceptible of much change in the short run when the psycho-institutional complex remains fairly constant.

Consequently, public investment must be increased by concerted central government action. Public works must be planned in such a way as to generate full employment and hammer out or avert cyclical fluctuations. The multiplier theory and the acceleration theory explain the process of subsequent expansion in income and employment. The income multiplier is the ratio of the change in income to the change in investment. The acceleration principle is the ratio between a change in induced consumption and induced investment.

The central government must also try to foster the marginal propensity to consume by a better distribution of income, appropriate wage and social policies and easy consumer credits. In certain cases, when investment is directed towards capital equipment or war production, consumption must be checked<sup>so</sup> as to bridge the inflationary gap.

It appears from this outline that compensatory fiscal policy is a potent tool in contemporary economic philosophy. The central authorities must manipulate their fiscal powers in such a way as to support their investment - consumption policies.

An operative fiscal policy requires two important things: a widening of the scope of taxation and central regulation or control of taxing powers. Central-local fiscal relationships have ~~evoked~~<sup>evolved</sup>, in late years, along these lines. In unitary and federal countries, income taxes, borrowing powers and various functions came within the purview of the national governments.

On the lower level, local finances must be geared to the national economy and must respond to the coherent programme underwritten by the central government. All levels of government within the same country must act in unison. Apart from some basic local services, local expenditures must dovetail with those of the central government, notably on capital account, so as to achieve full employment and to iron out economic convulsions. In sum, junior fiscal powers must harmonize with senior fiscal powers to reach nation-wide objectives.

However, national policies may be counteracted or nullified through local economic or fiscal anachronisms. Intergovernmental horizontal and vertical taxing, borrowing and spending powers can have distortionary or disruptive effects.

The present chapter is an endeavour to diagnose the salient features of interjurisdictional fiscal incompatibility



in the framework of the national economy. The local divergent action covers two fields, namely, local taxing powers and local spending powers.

## LOCAL TAXING POWERS

### 1. Introduction

Harmonious central-local taxation is a desideratum not easy to achieve. Two reasons may be invoked.

#### 1. The Inherent Incompatibility of Local Taxation

Local taxation lacks uniformity. It is hampered by economic and legal limitations. The local taxes often have a restricted coverage, inflexible levies and limited scope for graduation. The inherent revenue deficiency is a deterrent to the use of local tax-raising powers. The local levies, especially if dominated by special-interest groups are inclined to lower taxation in order to attract mobile capital and thereby maintain a competitive balance.

Similarly, local borrowing powers are hampered by economic and legal barriers. The local unit, unlike the national government, resorts to regressive taxes to service debts which may be largely borne by residents or institutions outside the local boundaries. A real debt burden and a re-actionary income distribution may be the consequences of local borrowing. In central borrowing, there is no "burden" and a transfer

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LOCAL TAXING POWERSI INTRODUCTION

Harmonious central-local taxation is a desideratum not easy of achievement. Two reasons may be invoked.

1. The Inherent Irresponsiveness Of Local Taxation:

Local taxation lacks malleability. It is hampered by economic and legal limitations. The local taxes often have a restricted coverage, inflexible ceilings and limited scope for graduation. The inherent revenue deficiency is a deterrent to the use of local counter-cyclical taxation. The local bodies, especially if dominated by special-interest groups are inclined to lower taxation in boom and embark upon capital works thus accentuating disequilibrium.

Similarly, local borrowing powers are hindered by economic and legal barriers. The local unit, unlike the national government, resorts to regressive taxes to service debts which may be largely owned by residents or institutions outside the local boundaries. A real debt burden and a re-actionary income distribution may be the consequences of local borrowing. In central borrowing, there is no "burden" but a transfer

of money from taxpayers to interest-receivers within the same country, and the debt is financed from progressive taxation. (1)

The legal impediments affect various forms. Local debts may carry ceilings or have to pass through specific channels. An illustration is afforded by the U.S.A. where local borrowing is based on the assessment valuation of local property so there is no elasticity in depression when property values shrink.

## 2. The inter-local Competition For Taxable Resources:

Local units, instigated by revenue deficiency, compete for taxable resources in such a way as to result in incoherent taxes and to wreck inter-local and central-local fiscal co-ordination. The lower tiers of government are animated, in their rivalry by two motives:

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- (1) The facts are, however, not as simple as that. The transfer<sup>4</sup> of purchasing power from taxpayers to stock-holders carry<sup>is</sup> important economic implications according to the form of borrowing and to the pattern of investment channels.

(a) Positive motives: An under-endowed locality strives to enrich its taxable resources by encouraging the establishment of new industries or by enticing industries away from other localities. This is often the case of urban communities confronted with many expenses and able to offer inducements,

(b) Negative motives: An impoverished locality may endeavour to stem the efflux of its taxable resources or to retrieve those lost. By conferring advantages to local factors of production it averts their efflux and the subsequent liabilities which would be left on its shoulders.

We may now pass to a more detailed study of individual local taxes.

## II. Local Property Taxation

There is scope, in the local taxation of property, for certain quantitative and qualitative effects on investment and consumption running counter to national economic policies. The points of friction may be caused by the form of the tax, its rates or changes in them, assessment procedures or exemptions. (1)

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(1) There are also <sup>the</sup> ~~other~~ inducements connected with real property, such as the provision of site and building at nominal rental, or their donation by the local authority.



Reference ought to be made to some specific illustration.

#### 1. The Property Tax Structure.

The form affected by the property tax is not without effects. An illustration is afforded by a tax on land which does not vary according to the value of land so as to leave unaltered its marginal uses, but affects the form of a flat rate per acre. In the latter case, extensive cultivation will be undermined to the advantage of intensive cultivation. (1) This causes a waste of arable land and may involve a reduction in agricultural output which, though price rises, can upset the national price plan, especially when central economic policy is laying emphasis on heavy industry.

In the case of industrial and business property taxation, it is to be mentioned that a flat rate is discriminatory since the percentage of fixed capital, and equipment when taxed, varies between branches of industry or trade.

If a local tax is laid on all property including new equipment, the marginal productivity of the latter must offset the levy. The tax, by imposing higher costs, affects the prospects of new capital equipment. Capital development will subsequently feel this adverse impact.

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(1) HUBBARD, Joshua C.: "Creation of Income By Taxation."  
Cambridge, Massachusetts, 1950. PP.14 - 15

Reference ought to be made to some specific illustration. The American (U.S.) property tax tends to shift investment from fixed improvements to movable and personal property, which are relatively lightly taxed, and to intangible property which is hardly assessed. The American tax has therefore an inhibitive effect on real estate improvement. Residential buildings tend to be below standard.

It is the writer's opinion that appropriate distinctions should be made, in property taxation, between the different uses; residential, commercial, industrial, liberal professions and so on. Certain points, in this connection, are discussed below.

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## 2. The Level and Changes of Property Tax Rates:

The burden and changes of local property tax rates, whether in the case of residential or industrial and business property, has various repercussion on investment and involve consistency or inconsistency with national developmental policies.

As concerns residential property, changes in the tax rates affect both the quantity and quality of housing. Whether the formal incidence is on the occupier or owner, a fall in the tax rates, especially in expanding regions or good times, fosters new building and repair work. Although the promotion of investment and employment is beneficial and fits in a growing economy, the application of financial, natural and human resources to certain uses, such as housing, may well clash with national planning putting the accent on short-term industrialisation.

Furthermore, the pressure on resources, of total demand of industry plus housing, generates price rises and subsequently increases building costs. The latter fact may cancel the advantage to investors in real property, of lower house tax rates.

On the other hand, high house taxes, or a rise in the tax, curbs new construction, especially in bad times or declining areas, and militates against the provision of adequate rental housing to the detriment of the low-income families. When the property tax is very high, it often happens that

dwelling houses are used as industrial and business premises, thus accentuating the shortage of housing.

After emergencies, such as war, when it becomes necessary to speed reconstruction and rehabilitation works, the high local property taxes represent an impediment to privately owned housing development.

However, the dampening of the incentive to build by high tax levels, may cause the national government to embark upon public housing schemes.

It is to be mentioned that in expanding areas or in times of prosperity, the effective incidence of the tax rise falls on the occupier and real investment will be less affected.

In sum, high house tax rates have significant economic and social implications.

As regards the property tax on industrial and business premises, a rise in the tax rate, if likely to be charged on profits in the short run, will tend to be shifted forward to the consumers in the long run. The taxes will be thus considered as an element of costs and will be taken in<sup>to</sup> consideration when formulating price policy.

In the U.S.A., 1,000 manufacturing concerns were asked, in an inquiry, whether the property taxes have been reflected in the price. Of the replies, 49 per cent were in the affirmative. (1)

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(1) KIMMEL, Lewis H. : "Taxes and Economic Incentives."

The Brookings Institution, Washington, 1950. P.159



In the writer's opinion, the effects of property taxation, in the case of industry and business property, can be of importance if there are substantial inter-local differences in their burden and notably when exemptions are provided for in some localities and not in others. Factory and business location is affected and the local areas which lose through their higher fiscal burden, suffer various financial and social consequences. The consumers living in highly taxed areas may also bear the differentially greater fiscal burden in increased prices. The consumers are however able to <sup>avoid</sup> escape the locally increased prices thanks to local retail markets escaping the tax, mail purchases, out-of-locality purchases and the multiple stores which can offset the high taxes in some localities with the low ones in other localities.

### 3. Assessment

The differences in assessment procedures, by type of property or by region, is not without repercussions owing to the varying effective tax rates.

In the case of residential property, the under-assessment of new houses, which amounts to a lower tax burden, enhances investment in building. Such tendencies harmonize with post-war national reconstruction policies and town-and-country planning. However, the diversion of resources towards investment in durable consumption goods ill accords with intensive industrialisation programmes by causing a cut in the rate of capital development.

Central-local lack of harmony may also obtain in respect of location. Only the wealthy areas are likely to avail themselves of underassessment since the latter is a luxury and too costly an expenditure for the weaker local budgets to bear. The fact that the wealthy localities are able to wage an unfair war for resources, through under-assessment, is undesirable. Furthermore, disturbances may be caused to location plans, centrally devised, involving reconstruction of specific devastated regions or housing development in certain blighted areas.

It is noteworthy that the <sup>general</sup> stickiness of valuation implies overvaluation in declining areas and under-valuation in expanding areas.

The lack of uniformity in assessment procedures is also noticeable in the case of industrial and business real property. Assessment may be at varying percentages of actual value and may differ according to the type of activity.

In the U.S.A., manufacturing realty is often under-assessed. Similarly, larger units, whether manufacturing or business concerns, tend generally to be under-assessed. The result of under-assessment, intentional or not, is discrimination against the non-manufacturing units in the first case or against the smaller units generally in the second case.

It is to be noted that the homestead exemptions and credits (1) also imply discrimination against the

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(1) According to the credit device used in Iowa, the taxing units do not lose revenue since they are reimbursed from the homestead credit fund (fed from state sales and income taxes).

manufacturers' property.

On the other hand, overassessment may be used by some local politicians as an instrument to combat big business.

Clearly, the differences in assessment between competitors makes it difficult or impossible for the handicapped industries to recover the tax.

### Exemption from Property Taxation.

The provision of exemptions from local property taxation has various economic, financial and social implications.

In the case of residential property, exemptions may be given to the taxpayer as in the U.S.A. where there are homestead exemptions granted on all or part of the assessed value or full value. The stimulative effect on private investment in construction depends on the magnitude of the exemption, the proportion of taxable property enjoying it and the percentage of home ownership within the local community.

As in the case of under-assessment, exemption may lead to a conflict between central industrialisation policies and local housing policies as a consequence of the drain on resources represented by increasing new building.

If a distinction is drawn between urban and rural residential building development, some remarks can be made. A regional government may indeed wish, for economic or social motives, to develop urban communities and thus provides for exemptions (or underassessment) to house-owners in its rural districts. If the region is agricultural, there is a likelihood that urbanisation will occur at the expense of arable land. Such a policy enters in<sup>t</sup>o conflict with a national economic plan laying stress on the increase of agricultural output and setting targets for further expansion of



farm land. The underlying authorities, by undermining these national objectives, contribute to raising living costs or hindering exports of cash crops.

Local homestead exemptions may not however be so undesirable if they encourage demographic migrational movements to virgin or desert lands where urban centres would contribute to commercial and industrial development.

In the writer's opinion, the exemptions to house-owners, when the tax is payable by the owner as in the U.S.A. and Egypt, are not a reform of property taxation. They rather undermine the latter's basis. Moreover, the preferential treatment of property owners creates a further privileged class or increases the strength of real-estate interests already dominating, as in under-developed countries. The writer is thus, in principle, opposed to homestead exemptions in under-developed countries.

Owing to the fact that the property tax is the residual local tax subject in many cases and in view of local revenue deficiency generally, the gap between property-owners and non-property-owners will be widened by the transfer of the local fiscal load to rental residential property and ~~the~~ tax shifting to the occupiers who may belong to the low income-groups..

Alternatively or simultaneously, the local authorities may be driven to obtain compensation for

loss of revenue on residential property, by increased taxation of business and industrial property including in some cases, as in the U.S.A., equipment and stocks. In other terms, local productive enterprise will be overloaded.

Exemptions may be also provided for in respect of business and industrial property taxation.

In this case, it may be said that it is not so much the exemption per se that has economic effects but the inter-local non-uniformity of practice in this connection. In other words, the effects will be greater the greater the diversity in inter-local exemptions. If the tax concession is universalised, its influence on business and factory location is neutralized.

In England, the total exemption of agricultural hereditaments and the partial exemption of industrial hereditaments are a universal practice all over the local units of the country and have consequently, no influence on the inter-local distribution of agricultural or industrial development.

However, the situation is not the same in other countries. In the U.S.A., a wide range of businesses, small and large, enjoy varying degrees of state and local preferential treatment. In consequence, business and industrial location cannot be left unaffected especially in the case of new industries and inter-local

concerns which are generally more mobile.

Factory location as affected by local taxing powers is not necessarily in harmony with industrial location as induced by the national government. The policy-framers, on the central level, may show the way to developments along different lines in response to technical, economic or strategic considerations.

The junior taxing jurisdictions, by countering such objectives not only defeat national policies but also possibly develop diseconomies or cause social waste or contribute to the distress of other local areas. The establishment of local infant industries and unsound business activities may ultimately prove a liability rather than an asset to the local authority.

#### Local Property Taxation and Consumption.

The effect of the local property tax on consumption and hence on the national economy, depends on its effective incidence and the level of the tax rates charged.

If the effective incidence falls on the occupier (which notably happens in case of shortage of rental property relatively to demand) the tax tends to reduce consumption not only because the demand on housing is inelastic but also because the non-property-owners can be generally assumed to have a higher propensity to consume than the property-owners.

Similar results follow increases in the land tax

which fall on the farmers.

On the other hand, if the effective incidence falls on the owner, consumption is less likely to be affected.

#### (4) Local Externalities

The local externalities of different levels of investment in different regions can be distinguished in two ways. First, the local externalities of investment in a region can be distinguished in two ways. First, the local externalities of investment in a region can be distinguished in two ways. First, the local externalities of investment in a region can be distinguished in two ways.

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## LOCAL INCOME TAXATION

Local income taxes are likely to be more operative than property taxes in their impact on the use of resources and the inter-local and central-local allocation of these resources.

### (A) Local Personal Income Taxation.

The local taxation of personal income has different repercussions which can be outlined from the viewpoint of their intra-local or inter-local aspects as well as from their central-local aspect.

If the local income tax is based on situs and applies only to income stemming within the local unit, and if income, accruing from outside the locality, is exempted, this amounts to an inducement offered to out-of-locality investment and enhances the ~~effuse~~ *efflux* of local resources. Furthermore, this situation gives rise to a local privileged class living on investments on "foreign" account. The inducement to extra-local investment exists even if the other localities levy income taxes since the fragmentation of income for the purposes of local taxation decreases the scale of progression. Moreover the outcome seems to be detrimental to the "situs" taxing authority since those who proceed to "outside" investments are likely to be high income-receivers enterprising and active residents.

It is noteworthy that the <sup>inter-</sup>local tax differential (or better the <sup>inter-local differential of</sup> central plus local <sup>taxation</sup> ~~tax differential~~) may induce the taxpayers to reside in lowly taxed areas in preference to highly taxed areas. Differentials in transfer taxes (i.e. death taxes) contribute to the same effect.

Local personal income taxation contributes to the various effects of central personal income taxation on, inter alia, savings and incentives. The joint impact will be accentuated when either central tax rates <sup>or</sup> local tax rates, or both, rise (or the exemption limits and allowances lowered). The same result is produced in case there is no provision for central-local tax deductibility or tax crediting. Since the Second World War, the central tax rates soared in many unitary and federal countries.

The repressive burden of central plus local taxation does not militate in favour of an abundant supply of equity capital. The dearth in the latter might exert an adverse impact on economic expansion and national income unless public investment plays an important part.

A further point may be noticed. The over-loaded taxpayers will attempt to re-equalize the marginal utilities of their expenditures after payment of the taxes, central plus local. Changes will affect relative demand and will be reflected on the producers in varying degrees thus bringing about a re-allocation of resources.

As concerns incentives, the junior taxing jurisdictions may prefer to lay income taxes only on specific flows of income instead of total income. The element of income most practically amenable to local taxation is wages and salaries. These are easily traceable locally and can be taxed at source. The present growing practice, especially in American municipalities, is illustrative of this fact. If this type of local taxation gains momentum and if the central-local fiscal burden on wage-earners becomes heavy under the stress of local financial need, the incentives to work will be adversely affected.

From the standpoint of national-local relations, the local personal income taxation, especially when assuming substantial proportions, may entail conflicts with national full employment policies and central economic control in general.

In so far as the national government aims at achieving a proper balance between savings, investment and consumption, an opposite action may be exerted by local taxing powers or spending powers as will be expounded in due course.

Whether the junior authorities can, or are ready, to manipulate their income taxes and outlay taxes with flexibility, in such a way as to offset inflationary and deflationary tendencies, is open to doubt in view of the general local revenue deficiency characteristic of local finances.

In connection with inflation and deflation, an interesting point may be noted. There may be in application, for the purpose of central-local fiscal co-ordination, a system of tax sharing whereby the national government has to hand over to the underlying authorities fixed percentages of central tax yields. If the taxes shared are important, e.g. the income taxes and if local sharing is substantial, the power of control of the central authorities will be hampered as the latter will not be able to carry out operative anti-inflationary or disinflationary policies. The "central" measures might well be contradicted by divergent measures on the part of the underlying authorities. The latter, in case of inflation for instance, would be left with large funds to spend probably as they please. The situation will be the more serious the more rigid are the portions of tax collections shared by the local authorities as when the percentages are inflexibly determined by the constitution. The ~~latter~~<sup>constitution</sup> may be, in turn, also rigid as is generally the case in a federal polity.

It is the writer's opinion that full consideration be given to this important aspect of intergovernmental fiscal policy conflict, whether in countries where it actually obtains or in countries where it is proposed e.g. the Central African Federation.

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PART THREE

(1) See, for remedial proposals, <sup>↑</sup>chapter IV "Intergovernmental Fiscal Co-ordination," Section I



2  
(B) LOCAL BUSINESS INCOME TAXATION

1. Volume of Investment: The local corporate income tax system may militate against a national developmental plan from the quantitative, qualitative or value points of view.

Clearly, the hodge-podge of local business taxes whether connected, little connected or unconnected with "impersonal ability to pay" is not liable to enhance the propensity to invest and may adversely affect the volume of investment especially when the latter is essentially non-governmental.

In federal countries, notably, the junior authorities impose not only taxes on net business income but also on gross receipts, capital stock and even the "privilege" of doing business within the borders of the subordinate unit. Some of the non-profit taxes can be interpreted as imposts on costs.

Generally speaking, the revenue deficiency of local authorities is an inducement to the latter, especially the pluritaxing ones, to soak local and inter-local businesses directly or indirectly.

It was already emphasized that the complexity and diversity of local business taxes and the lack of inter-local uniformity in fiscal powers generate overlapping and multiple taxation. The latter facts carry serious implications with respect to inter-local concerns which will thus be unduly burdened. Chain stores and mass-producing manufacturing undertakings with pan-local

activities and cosmopolitan income, are deterred from expanding. They are also put at a competitive disadvantage as against intra-local concerns. The outcome may be, not only a contraction of investment as planned on the central level, but also a rise in costs, per unit of output.

Hardship may well be caused to local firms owing to heavy compliance costs and trouble in paying even the tax on net income which involves the application of intricate formulas for the purpose of inter-local business income allocation.

In sum, the local corporate taxes accentuate the impact of the central corporate taxes whether on economic expansion, on capital structure (e.g. the proportion of borrowed capital to total capital) or on business organisation (e.g. the discrimination against the corporate form).

As regards economic expansion, the joint load of central plus local taxes on profits, by being too high (1), represents a drain on liquid working capital particularly in times of rising prices. The supply of investment funds will be adversely affected. This can lead to serious consequences in countries where private savings are short and where new capital formation has to rely on self-financing. The propensity to expand is thus impeded whilst capital development is the focal

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(1) Especially when no provision is made for tax credits in inter-local relations or for tax deductibility in central-local relations.

point of post-war economic policies.

2. Industrial Location: The inter-local rivalry for taxable resources induces some localities to offer tax advantages to extra-local businesses. Some local jurisdictions may provide for exemptions, others for underassessment or other concessions *such as donations of sites and buildings, low rents, non-interest-bearing loans or cash bonuses.*

It is noteworthy that the application, by junior authorities, of a particular form of tax is less significant, with respect to business and factory location, than the existence of local tax differentials or inter-local differentials in total taxes, that is, local plus central. (1)

The inter-area competition (sometimes keen as in the U.S.A.) to entice enterprises away from other localities may cause economic and social prejudice to the deprived localities and, occasionally, to the "attracting" locality itself. Furthermore, national-local co-ordination can be damaged. (2)

- (1) If central taxation is very high, the local tax differential will make a small difference in the inter-area total burden of central plus local taxation.
- (2) Certain lines of activity are not likely to be materially affected by tax differentials such as transport facilities and other basic services and retail stores.

The general and local detrimental effects of competitive

Various points may be underlined. Industries and other concerns may be induced to a less favourable habitat and productivity and efficiency thus suffer. The efflux and influx of enterprises clearly leave in their wake human distress and financial liabilities on the local budgets. The workers, as low-income earners, are not very mobile.

It is noticeable that the infant industries and the parasitic or "hobo" businesses are most liable to be lured. Their inter-local mobility, following slight tax differentials, is a disturbing factor not to be overlooked.

As the wealthy local units are better able to offer tax concessions, industries may tend to concentrate in particular areas. The development of poor and "backward" regions can be thus hindered. Furthermore, there will ensue an accentuation of inter-local economic disparities in per capita income.

Central-local harmony, with respect to industrial location, may not prevail. The "central" policy-makers may agree on a certain scheme for factory location based on nation-wide economic or strategic considerations. The latter aims can be upset through local divergent action.

See also: George C. S. :  
The New Centralization.

New York, 1941. P. 38.

See also:

Newcomer, Mabel :

Variation and Fiscal Policy.

New York, 1940. PP. 56-63.



The general and local detrimental effects of competitive bidding have been emphasized by many writers. Professor Benson, of Michigan University, may be quoted in this connection:

"The migrating firms leave behind them unemployment, higher welfare costs, higher taxes on the businesses and individuals who remain, more bankruptcies, and the full impact of the downward economic cycle. But, in addition, even the local benefits are questionable, since the practical subsidisation of certain companies tends to handicap others which are carrying their fair share of the community costs. Moreover, the small town which has attracted industries through tax exemption and other governmental concessions has more difficulty in maintaining adequate educational, health and welfare programs than one in which all parts of the community are contributing to the revenue. The immediate benefits of increased real-estate activity are more than counterbalanced in the long run by the decrease in social standards." (1)

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- (1) Benson, George C.S. :  
The New Centralization.  
 New York, 1941. P.38.

See also:

Newcomer, Mabel :  
Taxation and Fiscal Policy.  
 New York, 1940. PP.56-63.

In conclusion, keen competitive bidding is an undesirable tendency displayed by secondary authorities (e.g. states, provinces) as well as tertiary authorities, notably cities and towns. Various illustrations may be given.

In the U.S.A., the state of Mississippi allowed its municipalities to "acquire land and construct buildings for worth-while plants seeking healthy decentralized units in small and friendly towns."

A further striking illustration is afforded by a town in New Hampshire which offered to dismantle and set up a shoe factory of another town, together with the offer of a large building rent-free and a guarantee of \$5,000 against labour troubles! (1)

In Argentina, instances of competitive bidding are provided by such provinces as La Rioja, Mendoza, San Luis and Catamarca.

In La Rioja, exemptions are accorded since 1949 to industries expanding by 50%. Recompenses, affecting different proportions of invested capital, may be given to stimulate new industries. (2)

(1) Massachusetts Commission on Interstate Cooperation. Final Report to the General Court concerning the Migration of Industrial Establishments. Boston, 1939. PP.66-78.

(2) Patterson, Ernest F. : "Argentine Provincial Tax Systems". Inter-American Economic Affairs. Winter 1953. P.64.

The Province of Catamarca, in 1952, issued the Decree No.633 providing for tax exemptions to local industries. The first article may be reproduced.

"All industry that is installed in the territory of the province before December 31, 1962, with a cash capital of not less than 100,000 pesos, that has for its object:

- 1) the extraction, elaboration, transformation, or manufacture of products that up to now have not been industrialized in the province;
- 2) the development of activities of similar character to others already established in the province, that have for object the ends enumerated above, and with capital not less than the amount mentioned above.
- 3) hotels with capital not less than 100,000 pesos.
- 4) all other industry not included in 1), 2) and 3) that have a capital of not less than 100,000 pesos remain exempt from the following taxes for a period of ten years:

a - property tax on the land and buildings exclusively devoted to the industry;

b - licenses, including vehicles and stamp tax on judicial acts inherent in its constitution, implantation and activities of exploitation.

c - municipal fees and taxes that are not fees for retribution of services."

IV  
4. LOCAL OUTLAY TAXES.

The application, by secondary and tertiary taxing jurisdictions, of outlay taxes, whether partial or comprehensive, can exert distortionary effects and might well cause prejudice to the investment and employment policies framed on the basis of nationwide considerations instead of narrow local egoistic interests.

1. PRICES:

The commodity taxes, general or selective, levied by junior authorities on producers, wholesalers or retailers, are generally shifted to the consumers. The extent of shifting depends on various factors such as the territorial scope of the taxes, the elasticity of demand and supply, the conditions of cost, the degree of monopoly and market conditions.

Concerning the first point, shifting will be more difficult in a locality imposing sales taxes while the adjoining areas do not. Demand in the taxing unit will be relatively elastic. This is especially so with local industries which cannot possibly move out of the taxing jurisdiction as in the case of the extractive industries, such as farming, mining and forestry in which backward shifting, that is, capitalization of the tax, is likely to supersede forward shifting.

It may also be pointed out that, within sales-taxing secondary governments (e.g. provinces, states or counties) the fringe areas, such as towns and other tertiary units, will present increased difficulties of shifting for the local producers or dealers.



types applied by government layers, the more important is their impact on consumption. It is possible to estimate the

The forward shifting of sales taxes will induce an undue rise in prices through pyramiding, especially if the taxes are not levied <sup>at</sup> on the merchandising stage, that is, wholesale or retail. The price rise is also accentuated by taxes laid on food stuffs and other necessities. The minor governments cannot easily resist the temptation of burdening the latter as they find the levy in such cases particularly lucrative owing to the widespread scope of consumption and the inelasticity of demand.

From the inter-local and national points of view, the resort to local commodity taxation is conducive to disparities in price levels which may well disturb the general price structure and carry other important implications dealt with below.

## 2. Consumption.

The commodity, or sales taxes, of general or specific character, have a deflationary impact. They reduce the propensity to consume of the low-income receivers. With the high income groups, it is the savings rather than consumption that are likely to be affected.

The effects on consumption are more important in depression than in boom. Clearly, the curtailment of purchasing power is also most undesirable in times of over-savings. ①

The heavier the burden of consumption taxes, of all

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- ① Compare what happened during the thirties, in the U.S.A, where the states, which rely much on sales taxes, raised the <sup>tax</sup> rates thus adversely affecting business recovery.

types applied by government layers, the more important is their impact on consumption. It is possible to estimate the burden in relation to national income or disposable income and notably to total personal consumption expenditures. In the U.S.A., in 1948, the total collections from sales taxes, use taxes and gross receipts taxes of all kinds were about 11.7 billions or approximately 5.5 per cent of national income and about 6.5 per cent of disposable income. This was again equivalent to as much as 6.8 per cent of all personal consumption expenditures. (1)

From the standpoint of central-local relations, the contraction of consumption through local authority action falls in line with a national anti-inflationary drive. However, if the central authorities fix price ceilings the imposition of commodity taxes will either disrupt the price control system or result in the production of lower quality goods. (2)

A further point of friction may be pointed out. The national government may initiate a full employment policy based on an expansion of effective demand with a view to offset savings at full employment level.

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- (1) Kimmel, Lewis H. : "Taxes and Economic Incentives". The Brookings Institution, Washington, 1950. p.150.
- (2) A strange fact, in this connection, is that the central government in India has been granting subsidies to the state governments to keep prices at a low level; while the states have been imposing sales taxes.

The programme can be counteracted by local commodity taxation which has a restrictive effect on the propensity to consume. At times of underconsumption and oversaving, the central-local fiscal clash needs no comment.

The local divergent action may be attenuated if the local authorities spend the revenue so collected to increase social consumption. However, the local authorities do not always envisage the situation from this angle, especially when they are a-democratic in structure. They may make use of the tax proceeds to alleviate the burden of local taxation, for instance, by lowering the property tax rates or providing for more homestead exemptions. The lower authorities may also prefer to repay their debts.

### 3. Volume of Investment:

From the local and inter-local points of view, local sales taxes may be imposed by some taxing jurisdiction but not by others. If the local industry is subject, for instance, to a general sales tax, it will find it difficult to shift the tax to the consumers owing to the competition of tax free commodities coming from other localities. If the industry is mobile it may move to other localities. The efflux of business will consist either in moving the plants or diverting orders to other branches located outside the taxing unit.

Clearly, the exodus of local industries hinders local capital development and adversely affects local finances. Costs of production are likely to rise, the exodus of labour being a contributing factor.

On the other hand, some local industries are completely impossible to move such as the extractive industries (farming, mining, forestry). In this case, the tax, which cannot be shifted forward will be capitalized.

It is noteworthy that both the efflux of local firms and the capitalization of sales taxes will adversely affect local property values (1) and hence reduce local revenue from taxes imposed on the ownership of property generally as in the U.S.A.

Clearly, the junior taxing jurisdiction puts its own industries and trading concerns at a disadvantage vis-a-vis the extra-local or "outside" undertakings (2) operating in non-taxing areas.

(1) JENSEN, Jens P.

"General versus Selective Taxes."

Proceedings, National Tax Association, 1929. P.403

(2) However, compensatory taxes may be imposed on the commodities "imported" from across the border.



From the national point of view, the increase in prices caused by heavy manifold commodity taxes, induces a decrease in demand and brings output down whether under perfect competition or monopoly, the monopolist trying to equalize marginal revenue with marginal cost.

The curtailment of output clearly does not fit in a national plan based on an expansion of production.

It may be argued that integration and direct marketing will be fostered leading to the rationalization of production and the decrease in per unit cost.

However, integration tends to be monopolistic and the producers will then restrict output and increase prices to the consumers by more than the tax.

It ought to be mentioned also that a heavy burden of consumption taxes levied by local and central authorities, may adversely affect incentives and hence productivity.

Clearly, the general increase in prices is ~~an~~ *an important* ~~decisive~~ factor of wage increases, which, in turn, puts up costs of production and handicaps national investment development. Besides the fact that the trade unions are powerful, industrial wages are sometimes linked directly with the cost of living index as is the case in France since the last Pinay Government. Agricultural prices may be also linked with other prices as in the U.S.A. which applies the "parity formula."

#### 4. Maladjustments in Investment:

From the local and inter-local points of view, the sales taxes may involve discrimination between industries and businesses caused by the scope of the taxes or the pattern of the rate structure, whether in the case of general commodity taxes, retail taxes or selective taxes.

The uniform rate structure is particularly discriminatory owing to the differences in the turnover and the varying proportions of gross receipts or profits to capital invested. There are also structural differences between industries in the marketing processes and the degree of integration. The elasticity of demand for the various products and their social desirability is not the same. The uniform tax rates will be thus pyramided unequally in different industries or concerns.

It may be pointed out that the local taxes, based on turnover and imposed on manufacturers or traders, may affect the pattern of business organisation. Integration and the multiple stores will be fostered to the detriment of smaller firms and unit shops.

Reference must be made to the inter-local disparities in practice concerning the rate structure. If a locality resorts to uniform rates while nearby localities levy selective sales taxes at adjusted rates, the industries and businesses in the former case will be put at a disadvantage vis-avis their counterpart in the latter localities.

From the inter-local

It is the writer's opinion that the selective commodity taxes imposed at variable rates are better than the general or retail sales taxes applied at uniform rates.

From a general viewpoint, if some commodities are taxed and others are not, there will be an increase of demand for the non-taxed commodities which induces an increase in their prices. Changes in consumption patterns bring about changes in investment patterns which imply different resource-allocations not necessarily in harmony with the targets set by the "national" policy-makers.

#### 5. Local and Inter-local Trade:

Local business organisation may be affected by the burden, the scope or the structure of the taxes. It was already pointed out that a tendency towards "big business" makes its appearance in order to mitigate the tax. Integration and the multiple stores form reduce the number of stages at which the levy is due. Chain stores and inter-local concerns will also be fostered as they are in a position to offset taxes paid to a locality by their business in non-taxing localities.

A further illustration may be given. If a local general sales tax is levied at uniform rates, it will not be difficult to make wholesale an inter-local transaction thereby avoiding the tax, and selling in the taxing locality only at retail. This clearly affects local wholesale business.

Country in the north

by south. See

becomer, Mabel: Taxation and Finance

40. p.61.

From the inter-local viewpoint, the application, by the local taxing jurisdiction, of some form of "protective duties" on commodities "imported" from other localities, is not without repercussions. These "duties", called in the U.S.A. "use taxes" are compensatory taxes whose aim is to safeguard the competitive powers of local industry and business and also to protect the revenue productivity of the local sales taxes, especially if adjoining areas are non-taxing.

However, the local "compensatory taxes" are akin to internal customs and as such act as a barrier to inter-local trade notably when no credits are provided for sales taxes already paid to other jurisdictions on the same commodities. Clearly, these hindrances are also conducive to diversions of marketing channels.

It ought to be mentioned that the neo-tolls, affecting the country's internal trade, can be made serious if the taxing localities are allowed to discriminate against certain products "imported" from other local units. An illustration is afforded by the U.S.A. where some such right was granted to the states with respect to alcoholic beverages, by the Twenty-first amendment of the Constitution. (1)

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(1) "The Twenty-first Amendment in its attempt to protect the dry states in enforcing prohibition, opened the way to protective tariffs on liquor. As a result, more than half of the states have some form of liquor taxation that favors the domestic producer. Some have even gone so far as to place embargoes on the liquor of other states."

Compare the state margarine taxes protecting the dairy industry in the north and the cottonseed-oil industry in the south. See  
 Newcomer, Mabel: Taxation and Fiscal Policy. New York, 1940. p.61.



## 6. Foreign Trade

The heavy load of commodity taxation, caused or fostered by secondary and tertiary authorities, has its implications in the field of foreign trade.

Demand may be diverted from the expensive home produced goods to the less expensive imported products. The effect will be stronger in case the local sales taxes are not levied on the merchanting stage, wholesale or retail, but are laid on the production stage as the price rise will then be intensified through the process of pyramiding. The outcome is a leakage in the foreign trade multiplier,

On the other hand, the internal increase in living costs and prices of raw materials will cause an increase in the country's costs of production, especially if the taxes are imposed on production goods as well as on consumption goods and price pyramiding takes place. The competitive capacity of the country will thus be weakened on foreign markets. (1) However, if the local sales taxes are levied on the merchanting stage<sup>as suggested above</sup>, the central government may be able to offer rebates in

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(1) The attempt by the central government, or any intermediate authority (e.g. province or state) to remove or reduce a local sales tax should be conditional upon price reductions (or compensated by other taxes (e.g. excess-profits taxation)), otherwise higher profits result especially in monopolistic or oligopolistic positions.

order to stimulate exports. In fact, the outlay taxes cannot be easily shifted to foreigners and if shifted, they exert an adverse effect on exports and contribute to balance of payments disequilibria.

In conclusion, reference must be made to the fact that commodity taxation, central and local, is gaining momentum. On the local level, it is caused by the inherent revenue deficiencies of the minor governments and the invasion, by the central government of local elastic sources, e.g. income taxation. The National government has, indeed, to face new responsibilities of welfare and economic control. Furthermore, the costs of local services have gone up forcing the junior authorities to devise new ways and means.

In the writer's opinion it is important that the underlying governments be precluded from making extensive use of outlay taxes, general or selective, on account not only of their regressive impact but also of the inherent national-local economic conflicts. The taxing areas should be wide, for instance regions, states, provinces or large municipalities. The taxes could be laid on the merchanting stage (retail, wholesale) rather than on the production stage so as to avoid price pyramiding. The tax rates should vary according to the <sup>types</sup> ~~classes~~ of commodities instead of being uniform. Central administration and control must be fostered so as to alleviate compliance and collection costs.

It is also desirable to adopt, <sup>eventually</sup> ~~if possible~~, some form of central-local tax - sharing of outlay taxes, whether specific or general.

In any case, inter-local and national-local co-operation and co-ordination are essential in view of the various internal and external repercussions involved.

Borrowing at the local level, however, also involves (intergovernmental) financial discipline in various fields: investment, consumption, etc.

The utilization of money and labour resources at the lower level, through borrowing, is not necessarily achieved with the approval of the Government of the national economy as a whole, since the responsibility of the latter is to exercise the powers of the monetary policy.

Debt Allocation  
The local authorities borrow from the financial markets and are subject to local credit conditions. However, the responsibility for the allocation of the national resources is not shared by the local authorities, as they are not directly involved in the distribution of income which is concentrated in the hands of the "tax-free" local authorities. Indeed, local authorities are not directly involved in the allocation of income between the "central" and "local" sectors of the economy. It is therefore possible to create a class of privileged groups and to give the national authorities a role in the allocation of income.

(1) In the U.S.A., under the various general tax laws, the federal authorities, they often do not have the right to tax.

## SECTION: II .

### LOCAL BORROWING: AN ALTERNATIVE TO TAXATION

The tax revenue deficiency of local authorities may induce the latter to resort to borrowing.

Borrowing, on the local level, however, also generates intergovernmental economic conflicts in various fields notably investment, consumption, prices and income distribution.

The utilization of money and natural resources, on the lower level, through borrowing, is not necessarily achieved with an overview of the requirements of the national economy as a whole, hence the undesirability of leaving unfettered the borrowing powers of the underlying bodies.

#### *Income Distribution:*

In so far as the local authorities borrow from high income-bracket individuals and resort to local regressive taxes (whether regressivity is by type *of income* or by *income-brackets structure*) to pay the interest on their bonds, there results a maldistribution of income which may be accentuated by the issue of tax-free "local" bonds. Untaxed local and municipal bonds contribute, with "central" untaxed bonds to create a class of privileged persons and to widen the loophole making evasion possible. (1)

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(1) In the U.S.A., though the states generally tax interest on federal obligations, they often do not tax the interest on theirs.



within the same national borders and the propensity  
to consume may not be seriously affected.

Moreover, the expenditure of the proceeds of borrowing on consumption projects and municipal amenities which mainly benefit the high-income earners is conducive to more pronounced income maldistribution. A fairer income distribution is obtained through spending in such a way as to benefit the local community as a whole, for instance on health, assistance, slum clearance and various other basic services.

It is to be noticed that if the local authorities spend the proceeds, only or mostly, for consumption purposes, the servicing of the local debts will require further local taxation which is generally of a regressive character. This will be causative of more intra-local fiscal inequities. (1)

On the other hand, however, a certain amount of local borrowing power may dispense with further regressive or repressive taxation.

*Propensity to Consume:*

The maldistribution of income, on both taxation and expenditure sides, does not only result in less social equity but it also adversely affects the propensity to consume thus eventually hindering national full employment policies.

When the national government borrows, it generally resorts to progressive taxation to finance its debts. Purchasing power is transferred from high-income receivers

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(1) See Section III, "Local Spending Powers."

within the same national borders and the propensity to consume may not be seriously affected.

Local borrowing, however, is serviced through generally regressive taxation and involves a transfer of purchasing power from low income-receivers, with a high propensity to consume, to high-income receivers with a low propensity to consume.

Furthermore, the stockholders of local debt may be residing outside the borrowing locality, so there will occur a "siphoning of income out of the local area" (1) following the payment of interest or reimbursement of borrowed funds. The analysis also applies when the local authority embarks upon capital works. The initial and subsequent increases in income may benefit other localities (as will be expounded in due course) <sup>at a time when</sup> ~~while~~ the burden of local taxation increases. (2)

(1) HANSEN A, and PERLOFF, H.: "State and Local Finance in the National Economy." New York, 1944. P. 196

(2) Besides, most of the fiscal benefit ~~from~~ local developmental schemes accrues to the central government thanks to the income tax.

3. III Investment. Maladjustments in investment can also make their appearance. The increasing bidding for a limited quantity of savings by both central and local authorities raises the interest rates. Besides, the junior authorities may attract resources to channels not considered desirable from a national standpoint or they may promote investment at inopportune times thus intensifying the cycle. (2)

Local borrowing may also result in undermining the confidence of the private investor if it <sup>is</sup> used to carry out competing or ill-timed investment projects. If the central authorities, in a flexibly planned economy, prefer to expand private investment in a particular sector by inducement, their policy will be counteracted

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(2) See Section III

or even negatived.

It is noteworthy that the efficiency of local government enterprises and municipal undertakings may be lower in comparison with those run by private enterprise or managed by the central authorities. The outcome is a smaller output in goods and services obtainable per unit of local expenditure. Clearly, this implies a waste of resources and adversely affects the national dividend.

*Payment:*

The retirement by local authorities of their bonds may involve the country's economy in difficulties if it occurs at times of rising prices. The increased liquidity of enterprises and individuals bolsters up the inflationary tendencies.

A further point ought to be mentioned, Many local bodies, once allowed to borrow easily, might be tempted to increase their liabilities beyond their fiscal capacity and so embarrass their own finances and run the risk of defaulting on their loans. This is especially so since local borrowing is generally more expensive than central borrowing and is likely in under-developed countries to be dead-weight or passive debt rather than active debt. The massive insolvency of the lower authorities, consequent upon a general slump may be causative of much hardship. ①

The various considerations outlined above induced some national governments to bring local borrowing powers

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① Default on debt occurred, in the U.S.A. during the Great Depression, in 3 states; Arkansas, Louisiana and South Carolina as well as in 37 large cities (pop. over 30,000).



under control in respect of amount, interest rates, purposes and conditions of repayment. This is especially the case in planned economies and emergencies when it becomes necessary to gear local borrowing to national financial policies.

An illustration is afforded by England where borrowing by local authorities is now subject to the control of the Public Works Loan Commissioners (also called the Board), the Capital Issues Committee and the Parliament which has been endowed with more control over the amount of local borrowing. (1)

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(1) There are minor exceptions to central control concerning notably borrowing by mortgage within limits, borrowing by overdraft for temporary reasons, reborrowing for replacement of stock if the local body had the option to redeem. . See:

SCHULZ, Maureen: "The Control of Local Authority Borrowing By the Central Government." in: Essays on Local Government. Edited by C.H.Wilson.

Oxford 1948

P.161

SECTION: III

It is thus clear that the inter-local disparities in the fiscal position of the various localities are accentuated by the lack of tax uniformity, by tax

The junior governments may not act in concert with the central government in outgo as well as intake. Local fiscal and economic behaviour may be at odds with national long-term planning and anti-cyclical policies. The local divergent action thus accentuates economic fluctuations instead of smoothing them.

appropriate grant system as well as through progressive taxation.

#### I. Fiscal Equity.

As was already pointed out, expenditure of the proceeds of taxation cannot be overlooked in any accurate evaluation of the fiscal burden. Taxation entails subtraction, and addition through benefit, in its ethical-collective acceptance. The net balance or the fiscal residuum is the true criterium of the tax burden.

The junior authorities can, through expenditure, affect the fiscal pressure on taxpayers and consequently can influence the fiscal residuum. The local fiscal burden or better the total within each locality of local plus central taxation can thus be rendered less progressive, or even regressive, if local outlays result in benefits

the resources are diverted from the export industries, prejudice may be caused to the balance of payments.

accruing mainly or solely to the high-income earners.

It is thus clear that the interlocal disparities in the fiscal residuum of similarly situated persons are accentuated by the lack of tax uniformity, by tax competition between localities and by an uneven inter-local development of social welfare.

The central authorities can however intervene to equalize the quantitative and qualitative total "bundle of services (local plus central) between similar taxpayers residing in different subordinate units by means of an appropriate grant system as well as through progressive taxation.

In case the aim is to achieve over-all maximisation of social benefit, central cum local, the equalizing functions in connection with expenditure and taxation, will also be the responsibility of the central authorities.  
~~The lower authorities would have to not to disturb the latter in their~~

## II. Volume of Investment.

Local taxation and borrowing cause a reduction in savings. If the local bodies do not invest the monetary funds they recuperate, they exert a detrimental effect on the total volume of investment. Income and employment levels decrease. If exports play an important part in the national economy, and if the resources are diverted from the export industries, prejudice may be caused to the balance of payments.

### .III Timing of Investment

Local capital works, such as housing schemes, road building and other projects may be ill-timed and nullify the central counter-cyclical measures. Local investment may be embarked upon in boom rather than in slump, thus intensifying the pressure of demand on resources and increasing wages and prices. The costs of production go up for central and local investment purposes and inflationary forces are set off.

In slump, the junior authorities may contribute to a worsening of the situation by curtailing their expenditures on new works. (1)

It must, however, be recognized that proper timing of local investment is not always feasible as the local services or undertakings may be of dire necessity to the local community (e.g. water supply, electricity, sewerage-disposal plants).

### .IV Maladjustments in Investment

Central-local inco-ordination can generate distortionary resource-allocation effects.

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(1) In the U.S.A., state and local expenditures on capital works, which amounted to an average of \$ 2,104 million between 1925-29, declined to \$707 million in 1933 and \$ 616 million in 1935. See: -

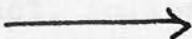


In a controlled economy, the national policy-makers may have devised a given preference schedule imparting first order to capital development or exports. However, the junior authorities, especially within a feudal or aristocratic polity, may go so far in providing welfare and other municipal amenities for the high-income groups as to generate a serious diversion of demand towards luxuries and semi-luxuries thus disrupting the national objectives of industrialisation or balance of payments equilibrium.

On the other hand, if the national plan puts emphasis on consumption and living standards generally, there may be agreement between senior and junior authorities.

More generally, the re-orientation of demand, through local action, requires some re-allocation of resources. If the central government does not respond to this pressure from below or if no central-local cooperation is possible, price rises occur in certain sectors.

V Geographic Leakages

An important fact must now be pointed out. A locality may strive to promote or restore its economy and may launch a policy of capital works. Such a locality will, however, find that the successive increases in income and employment are likely to benefit neighbouring areas. In fact, there is a further serious leakage in the multiplier, and acceleration principles in inter-local relations namely the "geographic leakage" which may weaken# even the primary effects of local investment since capital and raw materials 

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Similarly, in Great Britain, local governments may derive from other districts (1) Within the same country, the natural and money resources are likely to be unevenly distributed.

The experience of the U.S.A. provides considerable instruction in respect of central-local policy disharmony. The following passage may be quoted from Hansen and Perloff. It contains the gist of the problem; (2)

"In the past, states and localities have typically made large capital outlays in prosperous periods and have deferred capital improvements and even maintenance when business conditions were depressed. They have borrowed heavily when private capital markets were expanding and have curtailed their borrowing just at the time when new issues were needed to stimulate the economy. States and localities have in fact, followed the swings of the cycle and have thereby intensified the violence of economic fluctuations."

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(1) The usual leakages of the multiplier are price inflation, net imports, debt repayment and the accumulation of idle cash balances.

(2) HANSEN and PERLOFF: op. cit. P.199

See also:

Hicks, U.K.: Public Finance. Cambridge, 1947.

Similarly, in Great Britain, local government expenditure did not follow anti-cyclical lines. An example is afforded by housing which, between the two wars, was the main constructional activity. There was no planning for a reserve of building to be undertaken in recessions. Two of the three major expansion programmes were carried out in prosperity, namely, in 1921 and to a smaller extent in 1931. In the subsequent unemployment periods, these policies were abruptly reversed thus accentuating the cycle.

"On the whole, it appears that the most hopeful objective is the securing of a greater measure of stability in the total of local capital expenditure on all services, which would itself involve some measure of anti-cyclical timing in some services in order to offset inevitably cyclical timing in others. The degree of local and central planning, which the achievement of this objective would imply, would prepare the way for more ambitious attempts to secure large anti-cyclical movements of total expenditure and would, in so far as it tended to delay expenditure in times of prosperity, do something actively to assist them." (1)

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(1) Bretherton, R.F. - Burchardt, F.A. and Rutherford, R.S.G.:  
Public Investment and the Trade Cycle in Great Britain.  
 Oxford, 1941. P.201.

See also:

Hicks, U.K. : Public Finance. Cambridge, 1947.



PART THREE

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INTERGOVERNMENTAL FISCAL CO-ORDINATION

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## Chapter Five

## THE LOCAL TAXES

## Section I

### The Ideal Equilibrium.

T H E various aspects of inequities and inadequacies, inherent in junior fiscal powers, have been expounded. The analysis reveals the dire need for central-local fiscal co-ordination in order to achieve the following desiderata:

1. The elimination or mitigation of the sources of regressive and repressive taxation whether intra-local, inter-local or central-local.
  2. The dissipation or alleviation of the causes of horizontal and vertical overlapping and multiple taxation which are conducive to unfair treatment, higher costs of collection and compliance.
  3. Coping with the problem of revenue inadequacy through devising new local imposts or transferring others from higher to lower tiers, totally or partially. The underlying government units can be also provided with subsidies, both complementary and supplementary in order to adapt their revenue to needs.
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4. Central-local solidarity in the responsibility of securing a national (i.e. central plus local) quantitative and qualitative minimum of social benefits to all members of the community without distinction of residence and irrespective of local fiscal potential.
5. Rectifying local fiscal perversity in boom and slump so as to produce a coherent national economy exempt from intergovernmental conflicts.
6. The maintenance of a certain degree of local responsibility. The current centripetal forces must not be allowed to wreck the essence of local government. The latter is desirable for political and economic motives.

The problem of achieving these desiderata and reconciling them confronts us with an arduous task in view of the possible conflicts between the different objectives.

There are two lines of approach; one ideal and the other practical. The ideal solution is sketched in the present <sup>section</sup> ~~introduction~~. It is not a utopia, but both a target and a test.

The more practical course to follow is expounded, in more detail, in ~~sections one and two.~~  
*the rest of Part Three.*

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A N "organismic" community, senior or junior, must be guided in the conduct of its finances by two principles; one pertaining to taxation and the other to expenditure. (1)

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- Buchanan, J.M. "The Pure Theory of Government Finance, A Suggested Approach."  
The Journal of Political Economy. December, 1949. P.4 96  
"Federalism and Fiscal Equity".  
The American Economic Review. September, 1950. P.583  
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- Scott, A.D.: "A Note on Grants in Federal Countries."  
Economica. November, 1950. P.416  
"Evaluation of Federal Grants."  
Economica. 1952.

taxation and expenditure. (1)

If a rational economy prefers to follow these lines, an advanced community will try, moreover, to promote

(1) It must be borne in mind that this policy does not imply or secure any special level of taxation or expenditure.

Taxation must be applied in such a way as to equalize the marginal sacrifice of taxpayers. In such wise, the aggregate sacrifice for the area as a whole is made least.

On the other hand, the allocation of public funds between the various items of expenditure must be guided by the principle of equi-marginal social benefit. In this way aggregate benefit is made maximum.

The two principles above can be combined, by any layer of authority, so as to reach the optimum point in its revenue-expenditure policy. The optimum point is attained when the benefit derived by the marginal unit of expenditure is equal to, or just higher than, the sacrifice which the raising of that unit of revenue entails.

This financial policy secures the maximization of social utility or general welfare for given sets of taxation and expenditure. (1)

If a rational economy prefers to follow these lines, an advanced community will try, moreover, to promote

(1) It must be borne in mind that this policy does not imply or secure any special level of taxation or expenditure.

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the standard of its services.

#### National and Local Authorities:

In the case of the national government the principles outlined above find adequate applicability.

The fiscal powers of the central government are not impaired by geographical boundaries or circumscribed by legal limitations as regards the scope, level or structure of taxation. The federal authorities have now come to wield direct as well as indirect taxes and it is important that they should continue to do so.

On the other hand, the national government has, at its disposal, the whole country's resources and can spend in such a way as to equalize marginal benefits and to maximize social utility all over the country irrespective of local boundaries.

As for the underlying units of government, they can, each within its own sphere, proceed in taxation according to the principle of equi-marginal sacrifice and spend according to the principle of equi-marginal social benefit. Each junior authority is able, within its sphere, to reach the optimum point in its own finances.

However, if these principles can be successfully applied by any given locality, considered separately, they are distorted when all local units are viewed in their inter-relationships.

In fact, it is not possible for the diverse local units, to achieve inter-local equality of marginal

sacrifices. In wealthier areas the marginal sacrifice will be lower than in under-endowed areas because the former have a higher per capita income. The outcome will be inter-local disparities in the tax burden on similarly situated persons residing in different localities.

If the tax burden can be equitably apportioned from the national standpoint, this is not the case on the lower level as between junior authorities inter se.

The same analysis applies to expenditures. In the wealthy localities, the level of marginal benefits will be lower than in under-endowed areas which, while disposing of poorer resources, have to satisfy a stronger need for general welfare.

In sum, while the optimum of revenue-expenditure policy can be reached by the central government for its citizens and by each locality for its residents, it cannot be achieved for the nationals in their dual capacity of citizens and local residents unless the national government intervenes.

The Responsibility of the Central Government:

In the writer's opinion the national government should be saddled with a new responsibility in respect of fiscal equity. The latter concept should be extended to the spatial aspect of the taxation/spending process.

In the framework of central-local fiscal relations the inter-territorial side of fiscal equity carries important implications. The central government has the duty to  
equalize,



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between the diverse localities, the marginal sacrifices of central plus local taxation. In this way, the diverse subordinate authorities will have equal burdens of central plus local taxation on similarly situated persons. The aggregate sacrifice for the country as a whole is made least.

The national government, in order to achieve this policy, would have to resort to inter-local discriminatory central taxation. The wealthier localities will be taxed relatively more than poorer localities.

The analysis applies to unitary and federal countries alike.

This proposal has its counterpart in the field of expenditure. The national government must assume the responsibility of equalizing the marginal social benefit for the country as a whole, whichever is the locality of residence of the beneficiaries.

The taxing/spending process on the national level, in order to reach the optimum in public finance for the country as a whole, must thus equalize the benefit derived from the marginal unit of expenditure, central plus local, all-over the country's localities, with the sacrifice incurred in raising that unit of revenue by both senior and junior authorities, rich and poor.

In other terms, the national government must expand its expenditures in poorer areas and reduce them in wealthier areas. In a "social" community, the central government will prefer to increase taxation in the high-income areas, rather than reducing expenditures there, in order to spend more in under-endowed areas. If the national government decides to bring social utility in the

wealthy areas to a still higher level, it will have to increase its outlays in the poorer areas to a relatively greater extent.

To sum up, the central government must provide the junior authorities with additional funds which may be called subventions, subsidies or grants. These payments must serve a double purpose. They must level out inter-area discrepancies and also raise the actual level of social utility or general welfare.

In other terms, the subsidies will assume the character of complementary as well as supplementary payments.

In conclusion, it seems appropriate here to quote the expressive statement of Professor Johnson:

"In a democratic society, considerations of equity demand that governmental programs at each level treat all citizens in similar circumstances uniformly." (1)

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- (1) Johnson, Byron L. : The Principle of Equalization Applied to the Allocation of Grants in Aid." Bureau of Research and Statistics, Washington. 1947 P.88

## II Prospects of the Ideal Solution

### 1. Taxation

The national government's responsibility of reaching the optimum point in the dual taxation-outlay process for the country as a whole is very practicable in unitary countries where the central government is supreme.

In a federal polity, however, the proposal is strewn with obstacles.

In the field of taxation, the inter-local fiscal differentiation may be confronted with geographical barriers and constitutional impediments. The junior governments, being sovereign within their sphere, will object to such a policy on the ground that it is incompatible with the constitution and that it involves inter-regional discrimination.

It was already pointed out that the concept of fiscal equity must include a territorial interpretation and take account of the spending side. In the writer's view, modern federal constitutions, which are generally rigid and uneasy to amend, ought to be interpreted in their financial provisions, with this new spirit.

Moreover, the member states of a federation must be re-educated in thinking along the new lines outlined above and learn to put common interest before egoistic motives.

In the past they always objected to inter-area differences in the tax burden, but accepted willingly differences in per capita expenditures.

It is most important to be converted to the belief that the federal principle requires true and not apparent fiscal equality between the component parts of the federal polity.

It may be argued that the proposed policy of inter-local equalizing taxation has distortionary effects on the allocation of resources owing to a tax illusion. In a free economy, resources and labour combine so as to equalize the marginal productivity of similar units of labour all over the country's local units thus leading to production maximization. It is contended that this spontaneous distribution may be <sup>dis</sup>perturbed.

Apart from the fact that in a planned economy, the apportionment of resources follows a social scale of preferences, the suggested taxation system is not necessarily resource - distorting in a liberal economy. True, the tax illusion of a relative increase of the level of national taxation in wealthy areas might prevent labour from moving to where its marginal productivity is higher and might well induce labour to settle in under-endowed areas. However, labour is not all homogeneous and is not the only resource. The tax illusion of a lower <sup>national</sup> tax burden in poorer areas may prevent the efflux of skilled



labour from such areas. It may also encourage the influx of skilled labour, capital and entrepreneurship to the right place from the standpoint of maximum production. (1)

## *2. Expenditure*

The national government's duty to vary expenditures between its different subordinate units is not a difficult task when there is no substantial degree of decentralization.

However, as soon as de-centralization becomes strong, and especially in a federal polity, the underlying government units find fault with a national aid programme on the ground that it adversely affects their autonomy, damages their rights or disrupts local government.

The writer, however, strongly believes that such opposition is not tenable. In <sup>the</sup> first place, the central subsidies do not constitute a charity given to the junior governments. They are simply their natural

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(1) Buchanan, J.M.: "Federal Grants and Resource Allocation." in the Journal of Political Economy. June 1952. P.208

right since they are based on the requirements of an all-nation equilibrium and not merely on ~~limited~~ *narrow* local ~~indicia~~ *needs*. The national government, in the welfare phase, has the task of securing a national standard of services all over its subdivisions instead of merely filling the gaps of the local deficit budgets.

The national government cannot, in modern economic conditions, escape the duty of promoting the economic and fiscal capacity of the under-endowed areas. Local economy can no more be divorced from the national economy. Both must dovetail for the sake of national economic unity.

The writer advocates the resort to conditional rather than unconditional grants. In fact, the latter may be used in a manner inconsistent with the national policy or simply to alleviate local taxation. Nevertheless, it should not be impossible for the subordinate units to enjoy a certain degree of freedom, within the limits of the national interest. They can have separate tax sources ~~and~~ share others with overlying units. They can perform sundry basic functions without interference and carry out others in harmony with upper layers.

A cursory glance at the historical evolution of the present subdivisions of a country reveals that, in origin, they enjoyed, and ~~strived~~ *strive* for, political

independence. Gradually, they came to realise that their interests, mainly political at the time, had much in common and could be better served and promoted through unity, federation or confederation. Did the subordinate governments then disappear? In fact, they continued in existence as cells of one and the same body, developing both separately and concomitantly with it. They enjoyed political powers within the framework of the national polity. They also had an economic free hand.

Economics, however, assumed more and more importance. In the Welfare State and Planning State, ~~they~~ <sup>economics</sup> came to play a major rôle. Soon, a further cleavage occurred, namely that between local economy and national economy.

The new centripetal economic forces, inherent in the new phase of economic development, cannot be obstructed and must be canalized. The junior authorities must abstain from claiming anachronistic "rights" to be wielded in conflicting wise. Local economy must be integrated in the national economy.

In sum, the junior governments must be converted from their heresy of political or economic autonomy to the sound faith of common political and economic interest. Local economic freedom as occurred in the political field, must be a new type of freedom whereby local interests are served locally via those of the nation as a whole.

By having to renounce unhealthy rivalry, the local bodies do not have necessarily to disappear. They can live the new life of dignified collaborators, rather than that of discredited antagonists. The former political phase of development sustains this view.

Our analysis is applicable to unitary and federal polities alike. The modern phase of federalism is essentially co-operative.

However, the same solution cannot be appropriate to all countries. The conditions are different between unitary and federal countries and between countries of each category. A solution suitable at a certain time may not be so at some other time in the same country. However, various problems and aspects can be discussed with much benefit. The best course to follow would consist, for each country, in selecting

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(1) The focus can be summarized here as the need to: redress fiscal inequities and inequalities, avert overlapping, increase tax productivity, secure a minimum national standard of social services, integrate local fiscal policy in the national economy and preserve a desirable degree of local government.



SECTION II

TAX Co-ordination.

I. Introduction

Central-local fiscal co-ordination is not an easy task, especially when the proposed reforms are to be appraised on the light of given canons or criteria. These were set out in the prelude to the present chapter. (1)

Clearly, there is no perfect device. Each device discussed or suggested below has merits and demerits. Moreover, the same solution cannot be appropriate to all countries. The conditions are different between unitary and federal countries and between countries of each category. A solution suitable at a certain time may not be so at some other time in the same country. However, various problems and aspects can be discussed with much benefit. The best course ~~to follow~~ would consist, for each country, in selecting

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(1) The tests can be summarized here as the need to: redress fiscal inequities and inequalities, avert overlapping, increase tax productivity, secure a minimum national standard of social services, integrate local fiscal policy in the national economy and preserve a desirable degree of local government.

those reforms which comply with the greatest number of desiderata.

In this introduction, a few points must be clarified before proceeding to more detailed analysis.

1. The Problem of Local<sup>Tax</sup> Progression:

The two main points in this connection concern the determination of the tax basis and the form of the progressive schedule in local income taxation.

As for the former problem, two chief solutions can be pointed out. As the basis of situs results in the dismemberment of income and the distortion of progression, local taxation could proceed on the basis of residence instead of situs. Taxation on the basis of residence will have to be universalized all over the country's local areas, otherwise duplicate taxation would prevail. Income partition is thus avoided and progression becomes sound. However, it must be added that the debtor localities will be at a disadvantage. (1)

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(1) See below: Tax Crediting and Deductibility.

The locality of non-residence could be compensated (by central grants or part of the income tax collections of the other localities) according to such factors as the local average income, the importance of its income taxation and the proportion of its absentee property.

Another solution is to calculate the local tax on the entire individual income by both the locality of situs and the locality of residence, at the rates of each taxing jurisdiction and then allocate some part of the tax, so reached<sup>in each case</sup>, according to certain percentages, to the ~~different~~ localities concerned. For the sake of simplicity, it should be possible to omit the cases where a small or minimum proportion of income originates in the locality and also the cases of short residence. (1)

As for the form of the progressive schedule itself, it seems preferable to levy the local income tax at

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(1) Vickrey, William: Agenda for Progressive Taxation. New York, 1947. P.P. 319-320

percentage rates or at only mildly progressive rates especially when there is overlapping. It may be said that the smaller the locality, e.g. municipalities, the stronger are the reasons for percentage taxes, and the wider the local area, the stronger is the justification for (mild) progression.

It is to be mentioned that there is scope for local spendings taxes. The tax would be levied on residents only. This alternative would ease the question of local progression. However, there are various difficulties, besides those inherent in that mode of taxation. Account will have to be taken of the change of residence, residence and domicile, residence in different local areas, residence and working in different areas. Moreover, a local spendings tax militates against the locality where the income actually originated, <sup>the latter</sup> a fact which may be involving various charges on the local budget. (1)

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(1) Vickrey, William: Op. cit. PP. 326-328.



## 2. Pluritaxing Capacity:

A further point ought to be referred to. It seems desirable for the local units to have more than one source of taxation. Some types and forms are discussed or suggested below. Both stability and elasticity should be introduced in local revenue. Property taxation, in spite of its defects seems inevitable since it provides a desirable element of income stability. However, it was shown that the property taxes are not flexible in yielding capacity. This is especially felt in periods of increasing prices and expanding services such as we are now witnessing.

Consequently, pluritaxing authorities seem to fair better, as a rule, than monotaxing authorities. Here, however, the clash is clear between the two major desiderata of revenue productivity and fiscal equity and one must be cautious in the choice of the type and form of local non-property taxation. The difficulty is how to achieve a happy marriage between both forementioned ends. Once a proper balance is reached, it is still necessary to know how to make use of the tax sources adopted in such a way as to synchronize and harmonize with national financial and economic policies.

Clearly, the junior governments must realise maximum efficiency in local expenditures, otherwise their additional taxing powers would not be justifiable.

### 3. Centralization of Administration and Collection:

Two stages in the process of taxation can be distinguished, namely; the imposition of the tax and its administration and collection. Whatever is the tax, or mode of taxation adopted, it is highly desirable that the latter stage be, as far as possible, performed by the supreme authority or by a senior authority either exclusively or jointly with lower units.

*the necessity* The least that can be done, in this connection, is / to foster inter-local exchange of views possibly through an inter-local clearing house for information.

The benefits of unified administration and collection are undeniable. It copes with sundry points of friction especially in a federal polity where the junior governments may adopt personal and corporate income taxes or commodity taxes. Fiscal inequities, problems of situs, residence, allocation formulas, duplicate taxation are mitigated thanks to uniform practices of assessment, formulas, tax forms, discriminations and differentiations.

Unified, or joint administration, also result in less evasion, lower collection and compliance costs.

In pre-war Canada, when the provinces were income-taxing, some of them (Ontario, Manitoba, Prince Edward Island, Quebec) had entrusted administration to the Dominion Government.

In Australia, the state of Western Australia had made use, as early as 1920, of the Commonwealth Government to administer nearly all its revenue system. (1)

In the U.S.A. the Committee on Intergovernmental Fiscal Relations recommended the creation of a Federal-State Fiscal Authority to which the writer fully agrees and thinks its powers should be reinforced. The proposed Authority is destined to promote joint administration for overlapping taxes (especially income and death taxes) and inter-state co-operation in various fields such as cosmopolitan income. (2)

As the problem of local finances is more complex in federal than in unitary countries, the writer sees no reason why the members of a federation should not eventually take advantage of a principle conceded by federal constitutions, which militates in favour of inter-area cooperation, namely that of <sup>conventions</sup> ~~countries~~ or compacts.

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(1) Haig, R.M. : "Amalgamated Federal-State Tax Administration in Australia."  
Proceedings of the National Tax Association, 1937.  
Columbia, 1938.

(2) "Federal State and Local Fiscal Relations."  
78th Congress. 1st Session. Senate Document no. 69  
Washington, 1943. P.149

The latter can be formed in U.S.A., Switzerland and several Latin-American countries such as Mexico, Argentina and Brazil.

It must be pointed out, however, that these conventions or compacts suffer from the same points of weakness of international agreements in that they are based on reciprocal treatment and their enforcement rests on moral obligation.

Nevertheless, these inter-area agreements can still serve various useful purposes such as coping with evasion, reducing collection and compliance costs. They are likely to prove a step nearer <sup>to</sup> co-ordination. (1)

(1) For general discussion of fiscal co-ordination in U.S.A. see inter alia:

Seligman, E.R.A.: "The Fiscal Outlook and the Coordination Of Public Revenues."

New York University Symposium, Current Problems in Public Finance. Chicago, 1933.

Haig, Robert Murray.: "The Co-ordination of the Federal and State Tax Systems."

Proceedings of the National Tax Association, Columbia, 1933. P. 220

Newcomer, M.: "Co-ordination of Federal, State and Local Tax Systems" in the Annals of the American Academy of Political and Social Science. January, 1936. PP. 39-47.

Heer, Clarence.: "Co-ordination of American Federal, State and Local Finance" in Taxation and Public Policy, edited by Studenski, Paul. New York, 1936. P. 133

Shoup, Carl - Blough, Roy - Newcomer, Mabel.:

Facing the Tax Problem: Twentieth Century Fund. New York 1937.

Hansen and Perloff.: "State and Local Finance in the National Economy." New York, 1944.



## II Tax Crediting and Deductibility

Strictly speaking, tax crediting and deductibility are not species of central-local fiscal co-ordination but are rather ways of alleviating the regressive and repressive taxation arising from the co-existence of manifold taxing jurisdictions. (1)

Tax crediting and deductibility can be used for both central-local and inter-local relations. In tax crediting, a tax paid to an authority is reduced by another tax paid to another authority. Deductibility, as already pointed out, is a milder form since it only considers the tax imposed by the other authority as an expenditure to be deducted from a given tax base. (II)

If the two devices mitigate fiscal inequities, they do not do much about fiscal inequalities and overlapping since they do not cope with the problem of tax uniformity unless they are deliberately used as bargaining powers

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(1) For details see Chapter I, Section II, and Chapter II, Section III.

for this purpose or unless special variants are applied as will be seen. In fact, the junior taxing authorities could continue to levy independent taxes differing greatly in provisions or rate schedules from those imposed by the senior authorities. Moreover, the devices in question are an inducement to the lower governments to plunge into the troubled waters of income taxation.

Similarly, it is to be mentioned that deductibility and tax crediting are no remedy for fiscal perversity in boom and slump.

As regards local revenue, nothing is done to increase it. On the contrary, local revenue deficiency is sometimes accentuated as in the case of the local deductibility of the central tax. Moreover, the two devices are liable to advantage the wealthy income-taxing localities and do not benefit the non-income taxing ones.

However, tax crediting and deductibility, by reducing the pressure of higher plus lower taxation, may give the underlying units the opportunity of ploughing deeper and further into the lucrative field of such taxes as the income tax.

Clearly, the latter point is not desirable from the standpoint of fiscal equity as well as that of national local fiscal relations.

In the writer's opinion, however, if the subordinate units enjoy substantial financial rights and if no other

co-ordinating device is feasible, recourse should be had to deductibility, especially reciprocal deductibility, and tax crediting. The latter is also recommendable in inter-local relationships. (1)

Under central-local tax crediting, local revenue is not adversely affected while it is reduced in the case of mutual deductibility and unilateral local deductibility of the central tax.

It is noteworthy, however, that the national government, particularly in a federal polity, may not be much inclined to approve of the device of tax crediting which is liable to diminish central revenue relatively more than deductibility, whether deductibility is reciprocal or unilateral. This is true even in case of the most advantageous form, to the central treasury, of unilateral deductibility, namely; the local deductibility of the central tax and not the opposite.

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(1) In the U.S.A., the system of tax credits, in federal-state relationships, is confined to death taxation and payroll taxes for unemployment insurance. Tax crediting could be extended to the income-tax field. See:

Haig, Robert Murray: "The Co-ordination of the Federal and State Tax Systems."

Proceedings of the National Tax Association, Columbia, 1935  
P. 230

Report of the "Interstate Commission on Conflicting Taxation." 1935.

An interesting variant of central-local tax crediting worthy of careful consideration, is the graduated tax crediting, allowing for the benefit of the lower authorities, for high credit percentages on the lower brackets and lower credits on the higher bracket.

Two major merits may be pointed out. The progression of the total tax burden, that is, central plus local taxation, is safeguarded, contrary to what may happen in the case of independent levies or surcharges imposed by the secondary and tertiary governments. Moreover, the financial interests of the central treasury will be protected. The junior taxing jurisdictions will, indeed, be left with the low-income brackets, but will not be able to cut in the high-income groups.

In other terms, the proposal is a kind of central-local allocation of taxable resources or a species of separate tax sources by "brackets" which is both justifiable and practicable.

Similarly, reciprocal deductibility allows the central government to share a larger portion of the tax on high income groups than on the low income groups.

Now, it may be asked, if the subordinate units are allowed tax credits on central taxes and if inter-local fiscal uniformity of practice in this connection is fostered, as should be done, and if the central authorities



are entrusted with the administration and collection of the taxes considered, as is recommended above, would not this be akin to "tax sharing" whereby the senior taxing jurisdiction hands to the junior taxing jurisdiction part of the <sup>senior</sup> ~~central~~ tax yield?

### The Tax Credits in Inter-Local Relations:

It was already shown that the local units, in their taxation of income, have different alternatives. (1) On the basis of situs, they can tax all persons on their income derived from within the local area (whether the person is a resident or non-resident). On the basis of residence, they would tax the resident's entire income from whatever source. The locality can also tax both its residents on their entire income and the income of non-residents, originating within its boundaries.

The central authorities must assume several responsibilities in this connection which may be pointed out here:

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(1) See Chapter II, Section III.

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1. The national government should urge, or force, all the local units without exception to apply either the basis of situs or the basis of residence and not both simultaneously as then duplicate taxation would arise.

It may be pointed out that the basis of residence seems appropriate. The concept of residence will have to be defined clearly, without over-lapping and the definition will have to be universally adopted. The basis advocated safeguards the principle of progression (when the latter is adopted by minor governments for instance provinces or states). The basis of situs, on the contrary, distorts progression and discriminates in favor of inter-area income owing to the partition or dismemberment of income.

However, various difficulties will be encountered. Besides the problem of localizing certain flows of income (e.g. dividends), the debtor locality will be handicapped from the revenue productivity point of view. Moreover, the high-income receivers will tend to choose residence in lowly taxed areas. The central authorities must pay particular attention to the fact that various localities may still be tempted to impose taxes on, or to continue to tax, the non-residents, especially that the latter take no part in local voting or administration.

2. The national government may have recourse to another solution. When some local units adopt situs and

others residence and also when both bases of residence and situs are adopted by the same locality, the central authorities ought to foster or enforce the universal application of tax crediting, between the junior taxing jurisdictions inter se, for the sake of avoiding horizontal overlapping and multiple taxation.

The national government must here be cautious. It must universalize only one type of credits; either those allowed to non-residents for tax paid to the locality of residence, or the credits allowed to residents for tax paid to the locality of origin.<sup>(1)</sup> In fact, if both types of credits are in application simultaneously by different localities, either duplicate taxation or complete evasion will ensue. The national authorities should also not tolerate the application of both categories of credits simultaneously by the one and same local unit as this might well conduce to the claiming of two credits by the same person which also amounts to exemption. What the responsible authorities could do in this case is to allow the local units to adopt a discriminatory bilateral credit

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(1) ~~Chapter II, Section III.~~ It must be noticed that if there are differences between the local units in tax provisions and rates, there may still be duplicate burden even when credits of the same type are applied.

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system in which the locality would grant a credit to residents only when the locality of origin grants no credit to non-residents. The same former locality would also grant a credit to non-residents only when the other locality does not grant credits to residents.

It may be underlined that the device of credits to residents (for tax paid to locality of origin) is simpler and could be generalized or imposed by the national government. This device serves the interests of the debtor area since it does not affect adversely the latter's financial resources as happens in the case of credits to non-residents. Furthermore, the credits to residents are easier to administrate and offer the opportunity of effective auditing since all the credits figure in a single return.

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(1) Dierckx: "Local Government Finance in Germany." Public Administration, October 1930.

(2) Plahn: Proceedings of the National Conference on State and Local Taxation, 1915. P. 38



III  
3. Separate Revenue Sources.

This device has three interpretations or variants:

1. Complete or pure separation or "Trennsystem" in German terminology: (1) the local impost is here autonomous and quite different from central taxes.
2. Segregation: the local and central levies are different but they derive from the same source, e.g. rural property. (2)
3. Territorial division of the same tax source: in this variant the lower layers of government exploit the lower income brackets and the higher government layers exploit the higher income brackets.

Judged on the light of our six tests, the method of local independent revenue sources is more responsive to the two desiderata of fiscal equity and less overlapping. These are not, however, totally fulfilled as the junior jurisdiction, especially if monotaxing, might

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(1) Dhonau.: "Local Government Finance in Germany." Public Administration, October 1930.

(2) Plehn.: Proceedings of the National Conference on State and Local Taxation. 1915. P.58

be inclined to soak its sole or chief revenue source. The device, moreover, militates in favour of local government responsibility.

In the writer's opinion, the main defects of separate revenue sources are their limited applicability and their inadequacy to ensure that a satisfactory standard of services is attained in local units where per capita income is deficient.

In fact, pure separation cannot meet with wide practical application in modern conditions and could only be adopted in respect of minor taxes rather than major taxes. *The* Time of separation in the latter field (e.g. income taxes, death duties) "has gone by," as Professor Seligman puts it.<sup>1</sup>

The Brazilian Constitution of 1937 is the only important federal one which provides for complete separation of federal-state revenue sources.

Instances of taxes, which can be exclusively local, are those on immovable property, site value, entertainments, restaurants, petrol, motor vehicle, license taxes, general and selective sales taxes such as those on liquor or tobacco.<sup>2</sup> Some of these taxes are lucrative, such as

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1. Seligman: Studies in Public Finance, 1925, p. 174.
  2. Groves, H.: "Intergovernmental Fiscal Relations" in Viewpoints on Public Finance. New York, 1947, p. 499.

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the entertainments, sales and petrol taxes. They are advocated by the writer especially that they <sup>or can be made to fall</sup> generally fall <sup>groups</sup> on the high-income/ or on over-subsistence income (luxuries, semi-luxuries) thus complying with our first desideratum of fiscal equity emphasized above.

The municipalities, especially the rapidly expanding ones, could resort to site value taxes. These taxes are most desirable on several counts. They are levied on economic rent and are fair since they bear on unearned income. They do not adversely affect the supply and hence the prices of goods and services. (1) Adam Smith may be quoted in this connection: "Ground rents, and the ordinary rent of land, are therefore, perhaps the species of revenue which can best bear to have a peculiar tax imposed upon them. Ground rents seem, in this respect, a more proper subject of peculiar taxation than even the ordinary rent of land."

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(1) "The Rating of Site Values." Report of the Committee of Enquiry. London, 1952. P.6.

Clearly, the urban centres will find especially remunerative certain specific sales taxes, e.g. on liquor and tobacco and the taxes on petrol, motor-vehicle, and entertainments.

In England, a group of research workers recommended the abolition of agricultural and industrial derating and consideration of the taxation of land values and the transfer to the local level of the entertainments duty (which can and should continue to be administered from the centre).<sup>1</sup>

In the U.S.A. it is often suggested to relegate, *better* the gasoline, motor-vehicle and license taxes to the state level.

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1. "The Effect of Local Government Act, 1948" 5th Report. Inset in: Local Government Finance, Journal of the Institute of Municipal Treasurers and Accountants. March, 1953. The writer fully agrees with these recommendations. Agriculture can be better supported through open subsidies which would fall on the nation at large instead of embarrassing local finances by derating.



As regards the third variant of separation of sources, namely leaving the lower income groups to the local bodies and the upper income groups to the central level, it is equivalent to a tax credit of 100 per cent on the lower brackets. Tax crediting would be more in line with modern economic conditions of controlled economy, a prerequisite of which is <sup>the</sup> central <sup>control</sup> monopolization of the key-taxing powers, here the income-tax. <sup>(1)</sup>

Evaluated by our tests, tax-sharing has several merits. It promotes coordination of central-local taxation since it centralizes administration and collection and introduces uniformity of tax provisions. Various aspects of fiscal inequity and inequality are eliminated. The taxpayers, individuals or businesses,

(2) For discussion of the general principles of tax-sharing see:

Groves, Harold: "Financing Government,"  
New York, 1945. P. 457

Shaller, Alfred: "Public Finance,"  
New York, 1948. PP. 311-316.

Allen, Edward D. and Brownlee, S.H.: "Economics of Public Finance."

- (1) The system was advocated for the U.S.A. by Professor William J. Schultz.

(2) An interesting comparison could be drawn between tax-sharing and an old device, assignment. There are theoretical differences which may or may not lead to practical differences. Assignment puts emphasis on the senior authority, while tax-sharing implies some degree of local responsibility. Unless, assignment may involve the sharing of several, or all of the centrally administered and collected taxes.

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#### IV Tax - Sharing

The device consists in the upper governments administering and collecting the tax and sharing the proceeds with lower units. (1) It can be adopted in unitary and federal countries. In the latter case, it can be applied between any two tiers of taxing authorities. (2)

Evaluated by our tests, tax-sharing has several merits. It promotes coordination of central-local taxation since it centralizes administration and collection and <sup>fosters</sup> ~~introduces~~ uniformity of tax provisions. Various aspects of fiscal inequity and inequality are eliminated. The taxpayers, individuals or businesses,

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(1) For discussion of the general principles of tax-sharing see:

Groves, Harold: "Financing Government."  
New York, 1945. P. 457

Buehler, Alfred: "Public Finance."  
New York, 1948. PP. 611-618.

Allen, Edward D. and Brownlee, O.H.: "Economics of Public Finance."  
New York, 1947. P. 493

(2) An interesting comparison could be drawn between tax-sharing and an old device, assignment. There are theoretical differences which may or may not lead to practical differences. Assignment puts emphasis on the senior authority, while tax-sharing implies some degree of local responsibility. Besides, assignment may involve the sharing of several, or all of the centrally administered and collected taxes.

are spared the trouble of filing diverse tax returns. Personal income can be freed from the repressive burden of central plus local contributions and corporate income will be exempt from over-hundred-per-cent taxation. Overlapping and multiplicity will thus be greatly diminished. Evasion can be coped with. This is especially valuable in the case of some present commodity taxes as was seen with the tobacco and liquor state taxes in the U.S.A. Tax-sharing clearly reduces administration and compliance costs.

As for local responsibility, it is adversely affected by tax-sharing superseding more independent revenue sources. The junior authorities relinquish, not only the administration and collection, but sometimes decisions as to imposition and spending. In fact, tax-sharing may involve conditions for the expenditure of the proceeds and thus resemble conditional grants. (1)

Professor Groves <sup>sums up</sup> ~~resumes~~ the position, expressively, in the following terms:

"The fiscal independence of the local units under

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(1) The question tax-sharing versus grants is discussed below.

sharing is about the same as that of a minor son placed upon a revocable allowance by a generous father." (1)

Consequently, it is not easy, in practice, to persuade subordinate units enjoying a high degree of local home rule, to renounce their separate taxing powers in order to come under the thumb of the supreme authority or of some senior authority. This explains why in the U.S.A., there is no tax-sharing in federal-state relationships, while it exists between states and local authorities or municipalities. (2)

Tax-sharing does not comply with some vital points in our code of local taxation. It does not solve the problem of local revenue deficiency. It fails to achieve an all-nation minimum level of social benefits owing to an inter-area maldistribution of funds, inherent in the system itself.

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(1) Groves, Harold: Op. cit. P. 454

(2) Buehler, Alfred: Op. cit. P. 613

Groves, Harold: Op. cit. P. 458



Wealthy localities will have a superfluity of funds while under-endowed localities will continue to suffer a dearth of revenue, especially if the basis of revenue apportionment is that of "distribution according to contribution."

It is noticeable that the instability of tax receipts is not improved, with the result that local finances will still feel the impact of economic convulsions.

Furthermore, tax-sharing is not a cure for the fiscal perversity of junior authorities in boom and slump. The system, on the contrary, tends to accentuate economic fluctuations and follow them rather than counterpoise them. In boom, the rich areas may engage in extravagant spending and thus aggravate the inflationary spiraling of prices. In slump, the poorer areas find themselves unable to take compensatory fiscal measures. In these circumstances, central-local economic co-ordination is handicapped.

It ought to be emphasized that the power of the central authorities to use the income tax as an economic stabiliser, particularly in inflation, is impeded by the resort to central-local tax-sharing according to rigid proportions. Any increase in the tax rates will, in fact, augment in an automatic way the revenue accruing to the underlying authorities which, through their spending powers will accentuate the inflationary tendencies.

It is therefore important, in the writer's opinion, not to fix rigidly the percentages of tax-sharing for instance by including them in the constitution. Other ways of coping with the present type of central-local incompatibility is to except major emergencies (inflation, war ...) from the application of the pre-fixed tax shares or to specify that any further increases in the rates of the tax being shared will not accrue to the junior authorities. This idea has been adopted, and recently applied, in India by the Union Government in the case of the corporate tax.

It may now be asked, would not a rational (conditional) grant system better secure inter-local and central-local synchronism and economic harmony? Would it not prove more efficient in both normal and abnormal times? In other words, would not a central aid programme fit better in an integrated national economy and reflect more appropriately the new economic currents?

Is not tax-sharing so close to grants especially when the allocation of the tax proceeds has to refer to some criteria as in present grant systems?

Would not the gap between shared taxes and subsidies become narrower when expenditure of the former is governed by conditions which are made a sine

qua non to participation in central tax revenue?

Prorating of the Proceeds:

The central-local and inter-local allocation of the proceeds of the shared taxes is not always an easy task.

In some cases, clear criteria exist. The local units are then provided with sums equivalent to those which would have been levied. This obtains in some specific consumption taxes such as motor-vehicle and motor-fuel taxes, license taxes, where apportionment can take place on the basis of the relative number of registrations or the relative purchases of fuel. The entertainments tax can be easily allocated.

However, some specific sales taxes and ~~notably~~ <sup>sales</sup> general taxes present various problems. The determination of the local share requires information and book-keeping of local sales. The trouble and costs involved may annul the benefits of centralized administration.

As for income taxes, the way is strewn with obstacles. The prorating of the proceeds among the subordinate units encounters the issues of domicile versus situs and is taken in the mess of formulas for allocation of business income.

A way out of this impasse is for the central government to use its discretion. In this case, if local needs are not appropriately evaluated, the senior government's judgement will be arbitrary. Origin is an

objective criterium which, once abandoned, paves the way to political juggling.

The central jurisdiction may thus prefer to adopt certain indices of local requirements such as population, per capita wealth or per capita income or costs per unit of service.

In this case, would not tax-sharing have much in common with the grant system as already hinted?

#### Applicability of Tax-Sharing:

Tax-sharing is, however, a useful device. It can be adopted together with other devices. In the case of certain taxes and in some countries it is most helpful.

The conditions propitious to tax-sharing are, inter alia, the existence of clear bases for apportionment of the yields, serious overlapping involving inequities and high costs of administration and compliance.

If local home rule is not well developed, little harm will be caused and there will be no serious complaint over the "loss of sovereignty."

#### Tax-Sharing and Experience:

The system has ample scope for application in federal countries. It can also be adopted in unitary countries.

Germany knew the system between 1919-1933 when the Länder derived as much as 50 to 90 per cent of the revenue



of certain taxes, viz; income and inheritance taxes, turnover taxes and real property transfers. At present time, internal revenue from income and corporate taxes is split between the Federal Exchequer and the 9 Federal States. In the new fiscal year 1954/55 the proportions will be 40 per cent and 60 per cent respectively, as against 38 per cent and 62 per cent this year.

The device of tax-sharing also found application in South Africa and Australia. (1)

In Argentina, the most salient change, since 1930, in the provincial tax regimes, is the increasing participation in the centrally collected income, sales, capital gains, excess profits and unified internal taxes. In 1950, 47% of the general revenues of the Province of Córdoba derived from partaking in the above national taxes. In the same year, 65% of the general revenues of the Province of San Luis came from the same source. However, the proportion in the Province of Buenos Aires was only 24.7%. In 1951, the Province of San Juan obtained 49.6% of its financial resources through tax sharing. In Tucumán, the proportion, in 1952, was 43.5%. (2)

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(1) Adarkar, B.P. : The Principles and Problems of Federal Finance. London, 1933. pp.229-230.

(2) Patterson, Ernest F.: "The Tax System of the Argentine National Government". National Tax Journal. Sept. 1952. pp.267-274.

Patterson, Ernest F.: "Argentine Provincial Tax Systems" Inter-American Economic Affairs. Winter 1953. pp.38-39.

In India, the Niemeyer formula in 1936 provides for ~~the~~ central-provincial tax sharing in the proportion of 50/50 per cent. This basis of apportionment was not modified in the Constitution of 1947. (1)

Tax-sharing is found in state-local relations in the U.S.A. for gasoline, general sales and public utility taxes. The device is applied to a smaller extent in income and inheritance taxation according to different bases such as origin and population.

In the writer's opinion, the state tobacco taxes, in the U.S.A. are most amenable to tax-sharing. Federal administration and collection can do away with sundry problems such as overlapping and evasion. The sharing

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(1) Ghosh, B.B. : "Indian Economics and Pakistani Economics." Calcutta, 1949, p.556.

can take place on the basis of state consumption or the state's population, either weighted or unweighted.

It is noticeable that there is no tax-sharing between the federal government and the states as the latter are jealous of their "rights" and are not ready to lose their financial autonomy. Several observers and bodies, however, advocate state sharing in the proceeds of federal income and death taxes. (1)

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(1) See, inter alia, the report of the "Interstate Commission on Conflicting Taxation." 1935.

Local Supplements.

In this method the underlying units of government can levy surcharges on some central taxes, whether the surcharges are flat or progressive, with or without limitations.

The system has many merits. The taxes are administered and collected by the central authorities. This entails uniformity in tax provisions and eliminates various aspects of fiscal inequity due to overlapping. Costs of administration and compliance are reduced.

Great elasticity of revenue is obtained as the local units are given access to the lucrative progressive income taxes. Moreover, the localities can levy the percentages they think necessary to meet their needs.

As for local government, it is not damaged since there is no element of compulsion or subjection in the device. The local authorities can take the initiative and have the discretion to fix the tax rates and spend the proceeds.

In spite of these clear advantages, the supplementation of central taxes has still serious defects to count with. Fiscal inequity is not necessarily coped with unless both junior and senior authorities give due heed to the total burden and progression of central plus local taxation. This is especially the case when the



local percentages are not flat but progressive.  
 Total progression <sup>is likely to</sup> ~~will~~ be even more distorted if no limits are put on the local subcharges.

The idea of progressive local supplementation has been proposed for the Central African Federation, without limitation in respect of Federal personal income taxation but with a ceiling of one-fifth of Federal rates in respect of the profits tax. The threat to over-all progression, Federal plus territorial, is clear.

Furthermore, the minor authorities, in the case of local percentages, are not necessarily deterred from modifying the tax provisions thus hindering central-local and inter-local uniformity. The inter-area disparities in economic structure and <sup>per capita</sup> income may be among the responsible factors.

From the viewpoint of revenue productivity, there is the risk that the central government may change, reduce or annul, the tax subject to local supplementation. Moreover, the local units will still be victims of the vicissitudes of tax receipts in boom and slump.

A major objective is still not attained, namely: central-local fiscal policy co-ordination.

The system of local surcharges, despite the above criticisms is very useful and practical. It has

been advocated by many prominent economists notably Professor Seligman.<sup>(1)</sup> It should be recommended to countries where there is a high degree of local self-government, and where the local units could not easily concede what they consider the manifestations of autonomy.

The present tendency of municipalities in some countries, notably the U.S.A. to levy independent (though sectional) income taxes is condemnable and <sup>could</sup> should assume the form of surcharges. (2)

#### Local Supplements and Experience:

The system has been much in use in European countries, notably France, under the name of "centimes additionnels." In France after the tax reform of 1917, they were based on a "principal fictif" which is no more than the Four Old Wives, abolished between 1890-1917, viz. the land

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(1) Seligman, E.R.A.: "The Fiscal Outlook and the Coordination of Public Revenues."

New York University Symposium: Current Problems in Public Finance, Chicago, 1933.  
Also: Essays in Taxation. (10th Edition) P.668

(2) Sly, F. John.: "Tax Supplements for Municipalities."  
The tax Review, February, 1947.

*the (old) business tax*

and building tax, or patente, the property tax and the door and window tax.

The "centimes additionnels" also <sup>crept</sup> crept to other countries such as Latin America (e.g. Mexico) and the Middle East. (e.g. Egypt.)

The system never gained a foothold in the U.S.A. One or two states attempted to add surcharges on the federal income tax but <sup>soon</sup> ~~some~~ abandoned the idea. The only instances that can be given are the state supplementation, in some cases, of locally administered general property taxes. Certain levies on public utility are akin to local surcharges.

Many observers in the U.S.A. believe in the desirability of resort to state supplementation of the federal income and death taxes. Would the device be accepted by the states even if "approached by degrees" as Professor Groves suggests? (1)

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(1) Groves, Harold.: Op. cit. P. 458

## VI Realignment of Functions.

From the theoretical viewpoint, it is possible to apportion the various functions and services between the different layers of government in such a way as to saddle each tier with just enough responsibilities to counterbalance the revenue at its disposal.

Clearly, this course of action, as a means to achieve our six desiderata, is subject to limitations. True, it bridges or narrows the gap between local needs and means <sup>(1)</sup> and is more in harmony with present centripetal tendencies of the Welfare State and Planning State.

However, the transfer of functions to higher levels clashes with our sixth test of the desirability of maintaining some degree of local home rule. There are several basic functions (such as water-supply, cleaning, sewage disposal systems, municipal amenities ...)

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(1) In England, the transfer of education to the central level would cause a reduction in local rates of about a third, and in grants of nearly a half.



which can be better performed by the local units. Other functions can be carried out in co-operation with sister localities, or intermediate authorities or in full accord with the supreme authority.

The integration of local revenue and functions in the national system, in varying degrees, does not necessarily entail the disruption of local government. The new phase of local government, unlike its predecessor, is essentially co-operative, as already shown.

It is noteworthy, that taking existing responsibilities off the shoulders of local bodies, does not forcibly cope with the problem of local revenue deficiency. The effect can be nullified by such factors as the decrease in the value of money, inducing a rise in costs, or simply through the assumption by the local authorities, of other functions, whether new or caused by the expansions in services already performed.

## Chapter Six

### THE GRANTS:

#### PRINCIPLES AND PRACTICE

In fact, financial and technical assistance have been too often used as the excuse for doing nothing rather than as a means of giving.

The defects of such aid is that they do not have a wide coverage and are not based on the concept of securing, at least, a minimum of efficient service as a condition of further assistance.

## SECTION I

### The Grants: Principles

#### I. Introduction

It was already pointed out, ~~in the prelude to the present chapter~~, that a central-local aid programme must be based on the concept of an all-nation socio-economic equilibrium, equalizing the opportunities of diverse local areas possessing varying degrees of economic capacity and fiscal potential.

Grants are a double-edged weapon. If wielded in the way already suggested, or in some approximate manner, they prove beneficial indeed. If inadequately devised or improperly utilized, the subsidies can be actually damaging. They can aggravate, instead of mitigating, inter-area fiscal inequalities and quantum of social benefits. They can accentuate the divisive elements in federalism.

In fact, piecemeal and haphazard subventions have been too often used and the outcome was a disequilibrating rather than an equilibrating impact.

The defects of such aids is that they do not have a wide coverage and are not based on the concept of securing, at least, a minimum and uniform standard of social benefits all-over the nation's subdivisions.

Such subsidies may be imparted to promote no more than existing services or to meet certain individual services which are not interwoven into any nationwide rational scheme.

The grants may be also provided unconditionally. The recipient localities are thus enabled to indulge in services which do not foster inter-local social and economic adjustment. Moreover, making payments without imposing definite responsibilities is an invitation to local negligence or extravagance.

The local authorities may also spend the funds on various amenities benefiting the high income-receivers and thus accentuate the maldistribution of income. They may simply use the unconditional subventions to reduce local taxation.

The fact that a local authority is dominated by an oligarchy or is a reflection of an autocratic central government assumes, in the circumstances, great importance. Expenditure will be likely to benefit a local privileged social class rather than the mass of the local community. The reduction in local taxes, as an alternative use of the unconditional grants, will be of the kind benefiting the local "ruling class" rather than the low-income brackets. The outcome is clearly a fiscal pressure or a fiscal residuum, more regressive or less progressive in character.



It is now possible to give a cursory glance at various piecemeal aid devices to see to what extent they are responsible for inter-local socio-economic disequilibria.

The matching grants, in general, imply a certain local fiscal potential as they require local supplementation of central aid. If we consider the uniform-ratio or constant-ratio payments, it will be found that they militate in favour of rich areas with high economic capacity. The under-endowed areas, being unable to match the central grants, will get no or little financial help. Since the latter areas contribute to the national tax system, this means that the poorer areas pay for the wealthy ones. Clearly, this entails an accentuation of inter-local fiscal inequalities. (1)

It is noticeable that the fixed percentage grants involve further inequalities enhanced by economic fluctuations. In slump, the wealthy locality can take

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(1) Blough, Roy.: "Federal and State Grants-in-Aid," in Viewpoints on Public Finance, edited by Groves, H. New York, 1947. P.602

advantage of central subsidies with comparative ease, contrary to poorer localities.

Moreover, the percentage grants fail to account for the inter-regional differences in the cost of services.

Certain special formula grants are based on unsatisfactory means such as local population. In application, such payments militate against sparsely populated regions which may be deficient in resources and in need of development, while densely populated regions, better endowed, are favorably treated.

The variable-ratio grants have a definite advantage over constant-ratio grants in that they gratify under-endowed areas with relatively more funds than fortunate areas, for the purpose of performing a given service or set of services. The amount of the subsidy is in inverse relation to the local fiscal potential measured in some way or another (more of this point will be said later.) The wealthy areas, with high fiscal capacity, may not get any kind of help. (1)

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(1) Maxwell, James A.: "The Fiscal Impact of Federalism in the United States."  
Cambridge, Massachusetts, 1946. PP. 391-396

## II. THE EQUALIZATION GRANTS

The variable-ratio grants are more compatible with our fore-mentioned desiderata. Inter-local fiscal inequity is mitigated. Local revenue deficiency is more or less remedied making possible a certain minimum local service standard in particular fields.

However, the variable-ratio grants, by referring to individual services or a limited range of services, fail to achieve an all-nation socio-economic readjustment.

First of all, a national minimum standard of services must be chosen. The determination of the national standard, by no means an easy task, may take place at different levels. It may be equal to the average of non-central expenditures or may be higher.

1. Any comprehensive study of the equalization grants is not possible here as it would take us too far afield. This could be the subject-matter of a further separate study on the principles and practice of equalization grants, see, inter alia:

Johnson, Byron L.

The Principle of Equalization Applied to the Allocation of Grants-in-Aid.

Federal Security Agency - Social Security Administration. Bureau Memorandum, No. 66, Washington, 1947.

Maxwell, James A.

The Fiscal Impact of Federalism in the United States. Cambridge, Massachusetts, 1946.

Studencki, Paul.

Measurement of Variations in State Economic and Fiscal Capacity.

Bureau of Research and Statistics, Washington, 1943.

Woeller, Paul H.

Some Aspects of Problem Equalization.

National Tax Association, Proceedings, 1940.

## II. THE EQUALIZATION GRANTS.

The national aid programme, based on over-all socio-economic equilibrium, may be approximated through a system of equalization subsidies. Territorially discriminatory central taxation can be set aside. The equalizing grants advocated led to the desired objective of readjusting opportunities among individuals and local areas.

The general outlines of our proposal may now be expounded.<sup>1</sup>

First of all, a national minimum standard of services must be chosen. The determination of the national standard, by no means an easy task, may take place at different levels. It may be equal to the average of non-central expenditures or may be higher.

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Wueller, Paul H.

Some Aspects of Problem Equalization.

National Tax Association, Proceedings, 1940.



The principle of equalization itself is susceptible of different interpretations. The well-off areas, above the support level, may or may not be allowed to sustain higher service standards than the national minimum adopted. However, ideal equalization requires the disappearance of all inter-local divergencies on both taxation and expenditure sides.<sup>1</sup>

We need not dwell on these <sup>considerations</sup> intricacies. What interests us most, in this study, are the two following points which ought to be emphasized:

1. The determination of a decent national standard of services per capita, acceptable from the viewpoint of the new socio-economic criterions of the Welfare State.
2. The provision, for the local units, of central financial aid in direct relation with needs and in inverse relation with local fiscal ability. To put things differently, the recipient locality is to contribute directly in proportion to its fiscal potential and inversely in accordance with need.

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1. Referring to the U.S.A., Mr. Johnson says:  
 "Full equalization exists if Federal aid plus the amount each State could raise through expending a uniform percentage of its total fiscal ability (uniform effort) would together permit each State to spend a total amount that would provide a program equal to that in every other State, or, ignoring minor cost-of-living differences for simplicity's sake, a uniform amount per program unit - that is, per person served."

Johnson, Byron L.: op. cit., p. 92.

The subsidies ought to be conditional upon achievement, at the local level, of the national service standards.

We therefore require two things. On the one hand, an estimation, in respect of each locality, of the welfare service costs, central plus local, per capita in order to pave the way for an equalized level of services.

On the other hand, it is important to proceed to an evaluation of local economic capacity, the basis of local fiscal potential, so as to establish an adequate foundation for a national equalizing supplementation.

It is necessary to underline the need for periodical revision and readjustment of both measurements of local needs and relative fiscal capacity. This would account not only for changing local conditions but also for changes in the value of money or disturbances caused by emergencies and economic fluctuations.

Having evaluated local need for social benefits together with local fiscal ability, it is possible to obtain a sound system of grants which would vary according to both datums.

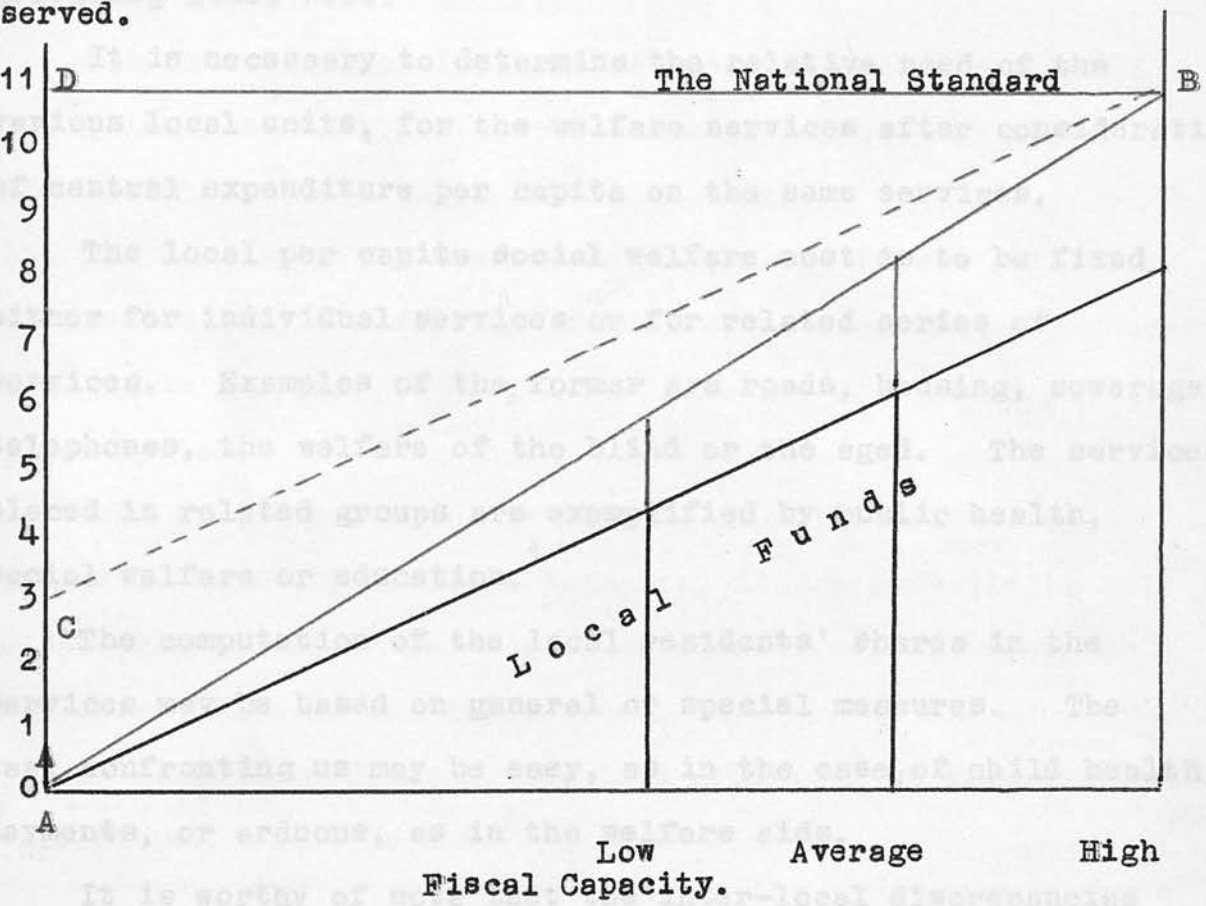
It is the writer's opinion that the subsidies be awarded to the junior governments as a right and not out of charity. The denominations of grant, subvention or subsidy are misleading and conducive to a misconception of the true central-local fiscal relationship within the framework of a modern national economy. "Adjustment or compensatory payments" seem more appropriate terms until better ones can be found.

The subsidies ought to be conditional upon achievement, at the local level, of the national service standards.

The payments must be conceived as a co-ordinated whole and form part of a comprehensive national plan.

Equalization Grants.<sup>1</sup>

Unit of account per person served.



- AB = Negative Equalization.
- CB = Zero Equalization.
- DB = Full Equalisation.

1. There are many devices of equalization grants. They all cannot be referred to.

It is to be noticed that the differences among these alternatives is not in total cost to the national government. The significant point lies in that equalization can be achieved with the same amount of funds differently apportioned.

#### Measuring Local Need:

It is necessary to determine the relative need of the various local units, for the welfare services after consideration of central expenditure per capita on the same services.

The local per capita social welfare cost is to be fixed either for individual services or for related series of services. Examples of the former are roads, housing, sewerage, telephones, the welfare of the blind or the aged. The services placed in related groups are exemplified by public health, social welfare or education.<sup>1</sup>

The computation of the local residents' shares in the services may be based on general or special measures. The task confronting us may be easy, as in the case of child health payments, or arduous, as in the welfare aids.

It is worthy of note that the inter-local discrepancies in the costs of performance may be also accounted for.<sup>2</sup>

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1. As under-endowed areas have a higher marginal social benefit than richer areas some weighting may be resorted to in favour of the former, at least at the beginning.
  2. The reasons for the eventual regional disparities in service costs are, inter alia, the co-existence of rural and urban areas, industrialised and non-industrialised districts, variation in population density. If demographic concentrations tend to lower costs per person served, it is to be mentioned that congestion may have an opposite effect as the law of diminishing returns makes itself felt.



It is not our purpose to enlarge upon the complicated problems which beset the measurement of local needs. Suffice it to stress that adjustments in the subsidies will have to be made for differences in local fiscal ability.

#### Measuring Local Fiscal Ability:

The assessment of local fiscal potential can be reached through the estimation of local economic capacity on which ultimately rests the local fiscal capacity.<sup>1</sup>

The aim is to measure not only absolute fiscal ability but particularly the relative fiscal capacities of the different local units in order to establish the basis of a sound equalization system.

When property was the prevailing form of wealth and formed the mainstay of local taxation, it was possible to rely on assessed valuation per capita on condition that valuation be uniform all-over the local areas.

In present conditions, the best criterion of local wealth is local per capita income.<sup>2</sup>

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1. Fiscal capacity is, of course, a segment of economic capacity.
  2. In England, it is possible to take, for the time being, the rateable value per head as criterion for relative wealth. This basis should be extended to all types of local authorities, not only counties and county boroughs, but also county districts (see below).

Clearly, the process of property valuation must first be improved. Actual rent would be taken as the rule rather than the exception. Valuation must also be made uniform all-over the country, a result which can be achieved through centralisation of valuation. In the absence of uniform valuation, underassessed areas benefit relatively more. The fact that underassessment is often found in wealthy areas further ~~cripples~~ <sup>prejudices</sup> the equalization purposes of the grants.

Local income can be computed either by the method of income payments accruing to the local residents or the method of income produced locally.<sup>1</sup>

In case local income taxation is resorted to by the minor governments (e.g. the American States) the former approach seems more convenient because it refers to ability-to-pay of the local residents more closely.<sup>2</sup>

There are arguments in favour of a combined measure composed of income-produced series and income-received series with possible weighting in favour of the latter.

In the writer's opinion, the method of income payments is more appropriate. It could include income in kind such as farmers' real incomes and house rental value to the owner-occupier. The inclusion of the former mitigates the discrepancies between areas where farmers produce only cash crops and areas where they also produce their own requirements. The inclusion of residential rental value ~~in the second case~~ is fair to localities where dwelling houses are predominantly rental as opposed to localities where they are predominantly owner-occupied.

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1. Clearly, it is meaningless to deduct local taxes paid. Income payments must include these taxes since the aim is to measure local ability to pay the latter. There is an opposite view favouring a "Disposable Income Series" corrected for all taxes paid so as to measure income available for private consumption and investment as distinct from governmental ones.
  2. In the U.S.A., the Department of Commerce series on state income payments are not unacceptable.  
No income-produced series have yet been computed.

It is noteworthy that income-payments series can be made more acceptable, for equalization purposes, by proceeding to adjustments for central taxes paid.

Consideration could be also taken, in measuring relative fiscal abilities, of the local distribution of income by brackets (and possibly by origin).<sup>1</sup>

Reference can be made to the proposal, put forward by certain observers, based on assuming a local model tax system. The latter would not be a mere reflection of the central tax system but would take into consideration local conditions.<sup>2</sup> The relative local fiscal capacities would be measured by applying such a system hypothetically and computing the amount of revenue which could be obtained thereby with uniform rates.

However, this procedure is subjective and rather arbitrary.<sup>3</sup> Needless to say, all the methods outlined require a great deal

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1. Some writers propose the resort to the method they call "Supernumerary Income" to determine central financial participation. In brief, the device consists in eliminating a subsistence amount for each local resident and consequently excluding, in the calculation of local per capita income, of all local persons whose income lie below the subsistence line.

Although Apart from the difficulty of determining subsistence line, this procedure tends to accentuate the inter-local disparities in fiscal capacity especially in under-developed countries where the rich tend to concentrate in certain areas. Moreover, equalization grants on this basis are less acceptable to the wealthy areas.

2. Such a model was framed in the U.S.A. in 1932-33, comprising income, property and outlay taxes.

3. Newcomer, Mabel:

An Index of the Tax-Paying Ability of State and Local Governments.

New York, 1935.

Blough, Roy: op. cit., p. 604.

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of statistics which, although national in nature, must specifically refer to the local areas. This is by no means an easy task.

#### Equalization Grants and Tertiary Authorities:

The central equalization grants, as already outlined, ought to be extended to all subordinate units of government and not restricted to a certain category of local units.

This fact is of especial significance in a federal polity where the equalization principles must find application in state-local relations as well as federal-state relations:

“As the Federal Government adopts equalization formulas in its own aids, it has every reason to urge that the States do likewise to help assure that the basic purpose of the equalization principle is served all the way down to the local units, where the program gets translated from dollars and paper into services to the public. Federal-aid acts embodying equalization processes for Federal grants should, therefore, place upon States the responsibility for securing equalization within their own confines.”<sup>1</sup>»

In the U.S.A., the state-local subsidies are, at present, based on the value of property as reflected in assessments. Although this is not a satisfactory basis for local (as distinct from state) taxable ability (income-payments could be here also adopted) it is most important to <sup>make valuation uniform.</sup> ~~equalize assessment~~. The latter ought to be carried out at least at state level and should not be left to the local authorities and to elected (not <sup>nominated</sup> ~~maintained~~), inexperienced assessors.

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1. Johnson, B.L.: op. cit., p. 206.



### III The Fisco-Economic Implications of Equalizing Grants

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Judged on the light of our set of desiderata for fiscal coordination, the proposed equalizing grants of the ideal or proximate types, have the following merits:

1. They mitigate local revenue deficiencies thus allowing less local reliance on regressive taxation by type or by bracket.
2. They alleviate the problems of overlapping and multiple taxation by softening the general scramble for revenue, notably the inter-local tax rivalry.
3. The central progressive taxation, made necessary to provide the financial aid to local authorities, leads to an inter-local redistribution of wealth.
4. Social equity is devoid of sense unless supported by economic equity. The equalizing grants, by making possible, a national minimum standard of health, education and other social benefits, leads to an income class redistribution of wealth and to effective ~~of~~ social equity, now recognized as a right to all citizens irrespective of their place of residence.
5. It is sometimes contended that central supplementation of local outlay in under-endowed areas, especially

if destined to finance purely local benefits, imposes an undue burden on wealthy areas. It is also thought that the whole procedure has resource-distorting effects as labour and capital must be left to combine in such a way as to maximize production.

However, the modern concept of full employment policies emphasizes the need to promote effective demand at the central as well as at the local levels. Local outlay must be allowed to reach such a standard as to be a contributing factor in maintaining a nationwide satisfactory volume of investment and consumption. Weak localities must not be allowed to undermine such objectives. The low propensity to consume in "backward" areas is a hindrance to investment promotion and must be raised. The equalizing grants, by promoting local social services, are a step in the right direction.

Furthermore, local outlay in all areas, whether wealthy or poor, must proceed in such a way as to hammer out economic fluctuations. Providing an under-endowed area with funds enables it to perform its share of compensatory public works and compensatory finance generally in the framework of the national policy.

It is worthy of note that the equalizing grants, by fostering the economic capacity of poorer localities, develop their fiscal capacity and ultimately reduce the need for equalizing grants.

From the social point of view, it cannot be overlooked that depressed areas, with their plight of unemployment and misery, are a source of danger to the nation and cannot be tolerated within the "Welfare State."

Last, but not least, the writer deems appropriate to make an expressive quotation from the Report of the Royal Commission on Dominion-Provincial Relations (Canada). (1) The Commission deprecates the maintenance of inter-area economic discrepancies:

"The investors in other provinces will suffer in the case of public or private insolvency among their neighbours. The producers in other provinces will suffer if markets are destroyed. Migrants must be admitted from depressed provinces and it is not merely a nuisance and an expense but a positive danger to the more prosperous provinces if these migrants are illiterate or diseased or under-nourished. Nor is the

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(1) Book II.

danger of competition from substantial labour in a distressed province a peril which can be disregarded. More important than all these considerations taken together is the danger to national unity if the citizens of distressed provinces come to feel that their interests are completely disregarded by their more prosperous neighbours and that those who have been their full partners in better times now tell them they must get along as best they can and accept inferior educational and social services.

judged on the light of our desiderata. The percentage grants, especially the fixed-rate variety, do not only fail to take proper consideration of the special conditions of the various local authorities and the disparities in costs, but they also assume a certain local fiscal potential. Moreover, they sometimes induce extravagance in spending.

The constant-rate subsidies do not necessarily ensure a minimum standard of services in all localities and in bad times as well as good times. They also do not mitigate the inter-area tax differentials. (1)

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(1) Drummond, J.E. "The Finance of Local Government," London, 1952. pp. 89-111.

Chester, D.E. "Central and Local Government," London, 1951. Chapters V and VIII.



## SECTION II

### The Grants : *Practice*

#### I. The United Kingdom

Before 1948, the grant system consisted of two elements, namely: specific percentage or unit grants and a general fixed grant. There were subsidies for police, education, and housing besides the Block Grant of 1929.

The whole system was very unsatisfactory when judged on the light of our desiderata. The percentage grants, especially the fixed-ratio variety, do not only omit to take proper consideration of the special conditions of the various local authorities and the disparities in costs, but they also assume a certain local fiscal potential. Moreover, they sometimes induce extravagance in spending.

The constant-ratio subsidies do not necessarily ensure a minimum standard of services in all localities and in bad times as well as good times. They also do not mitigate the inter-area tax differentials. (1)

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(1) Drummond, J.M.: "The Finance of Local Government."  
London, 1952. PP. 89-111

Chester, D.N.: "Central and Local Government."  
London, 1951. Chapters V and VIII

The unit grants, as in housing, have various demerits. There are inter-area differences in costs. In periods of price instability, as in post-war conditions, a periodical revision of the estimates of costs must be undertaken otherwise the subvention loses touch with the actual needs of the local area.

Furthermore, it is sometimes difficult to find a satisfactory unit.

The Block Grant of 1929 was intended to meet local expenditures on services generally. It was distributed to counties and county boroughs on a per capita basis after weighting their actual populations. Allowance was made for child population under five years of age, for low rateable value per head of population, for the proportion of unemployed and for sparsity in rural areas (in counties only other than London.)

The Block Grant failed to correct the dispersion in rate poundages and fell short of ensuring an all-nation average standard of services.

The basis of weighting was subsequently shattered. The ageing of the population weakened the child population factor. The transfer of public assistance to the central level had a similar result in respect of the unemployment weight. As for the low rateable

value ceiling, the increase in rates caused it to have an inter-area disequalizing impact. (1)

According to Mrs. Hicks, "The whole formula with the exception of the rural sparsity weight, has thus more or less collapsed as a result of external forces." (2)

It is noteworthy that the absence of any negative weight was also a factor in limiting the rate equalizing effect of the formula.

Professor Chester finds that the actual unweighted population was an important element in the sum apportionable according to the formula, forming around 40 per cent of it. As in highly rated localities, expenditure per head on basic services is higher and rateable resources per head lower comparatively to wealthier localities, the rest of the formula-distributable amount will have first to counterbalance these effects, and then exert its inter-local equalizing impact. (3)

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(1) Hicks, U.K.: "The Grant Provisions of the Local Government Bill." Bulletin of the Oxford University Institute of Statistics. February, 1948. P.33

Hicks, J.R. and Hicks, U.K.: "The Beveridge Plan and Local Government Finance," in The Review of Economic Studies, 1943. P.1

(2) Hicks, U.K.: Op. cit. P.39

(3) Chester, D.N.: Op. cit. P.267

It must <sup>also</sup> ~~also~~ be mentioned that the Block Grant was only part of the total financial help to local authorities. ~~Moreover,~~ <sup>Compensation</sup> had to be provided first for losses caused by derating and cessation of previous grants. Thus only part of the general grant was to be distributed according to the formula. This meant 34 percent in the first and second periods (1930 -1937) and 56 per cent in the third period.

The central aid system was an inducement to economy and did not respond to the increase in local expenditures which, combined with national expenditures, would have raised the standard of services, enjoyed by the citizens in any locality, to an agreed ~~total~~ national minimum. In fact, the block grant was not only based on a stilted formula but was also ~~revisable~~ <sup>revisable</sup> each five years thus lacking ~~the~~ <sup>in</sup> responsiveness to actual local requirements. The increase in the general subsidy always lagged behind the increase in expenditures of underlying authorities.

The Exchequer Equalization Grant took, in 1948, the place of the Block Grant. It co-exists with some other specific grants notably for education, health, housing, highways and police.

The amount of the Equalization Grant, which is payable to counties and county boroughs, is equal to the sum produced by the rate poundage which would be



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necessary to cover the local authority's expenditures if a certain "credited" or additional rateable value existed in fact. This "credited" rateable value is based on the deficiency in rateable value per head of the local weighted population compared with the average for England and Wales, the difference being multiplied by the local weighted population. The weighting considers the <sup>number of</sup> children under 15 and in certain counties, the mileage of roads. In other words, the Exchequer accepts to be ratepayer to the locality in so far as there is a deficiency in the latter's rateable <sup>value</sup> ~~volume~~ per head relatively to the average for the whole country. The authorities above the average are not entitled to be grant-aided.

A necessary corollary of the scheme is to have a uniform valuation of property all over the various areas, otherwise localities with low rate valuations, and those resorting to deliberate under-assessment, will secure more subventions. Consequently, the Inland Revenue was made responsible for valuation by the Local Government Act of 1948.

From the point of view of fiscal inequalities, the Equalization Grant achieved much rate equalization, by narrowing the difference between the two extremes and the spread about the average. It is ~~probably~~ more

appropriate to say that the grant equalizes the rating resources rather than the rates levied, or that it attempts to achieve the proportionality of rate poundages rather than the equalization of rate poundages. The latter objective would require the national government to subsidize the underlying authorities up to 100 per cent of local spending of any size above the standard rate level adopted for equalization purposes. (1)

The following table discloses the differences, in rate equalizing effects, between the two systems of general grants: The Block Grant and the Equalization Grant,

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(1) The Effect of the Local Government Act 1948 and Other Recent Legislation on the Finances of Local Authorities. Fifth Report. A study by a Research Group. Inset in: Local Government Finance. March, 1953. (Journal of the Institute of Municipal Treasurers.)

# Inter-Local Fiscal Inequalities

## County Boroughs

### Rates Levied (1)

	1928- 1929	1938- 1939	1945- 1946	1946- 1947	1948- 1949	1949- 1950
	s. d.	s. d.	s. d.	s. d.	s. d.	s. d.
<u>Average</u>	14 6	14 0	15 6	16 11	18 1	18 3
<u>Upper Quartile</u>	16 6	16 0	17 10	18 10	19 8	20 0
<u>Lower Quartile</u>	12 0	11 6	13 6	14 10	17 0	17 0
<u>Highest</u>	29 0	27 6	29 0	30 0	24 6	25 0
<u>Lowest</u>	7 1	7 10	9 0	10 0	11 6	11 6
<u>Differences</u> between 2 and 3	4 6	4 6	4 4	4 0	2 8	3 0
<u>Differences</u> between 4 and 5	21 11	19 8	20 0	20 0	13 0	13 6

(1) Chester, D.N. Op. cit. P. 275

(1) Hicks, W.E. Op. cit. P. 42

From the viewpoint of revenue productivity, the system assumes great elasticity not only because it is calculated annually but especially because it links the grant with actual local expenditures or with local propensity to spend. Mrs. Hicks rightly described the grant as "Earn-As-You-Pay." (1)

As for the objective, set down <sup>above</sup> below, of attaining a minimum national local service standard within all localities, it has been fostered through the various specific and general subsidies and the promotion, at the central level, of certain vital social services.

It is however the opinion of the writer that there is no merit in fixing a national average for the datum line. All junior authorities must participate in the aid programme. The latter should not be confined to a certain category of sub-standard authorities. In the present device, the average rateable value will have to be raised, from time to time, so that the total amount of financial support does not fall below the level of 1948/1949.

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(1) Hicks, U.K. Op. cit. P.42



# Local Financial Structure

## England and Wales (1)

1950 - 1951

	£ Million	£ Million
<u>Local Taxation</u>		
Rates including transport and electricity.		305
Fees, rents, trading profits transferred in aid of rates and other recoupments.		140
All Local Sources.		445
<u>Government Grants</u>		
<u>Specific:</u>	225	
Education £ million 152		
Health 16.5.		
Housing 22		
Highways & Bridges 13		
Police 25.5		
Other grants, none of which exceeds £10 million 26		
255		
<u>General Equalization</u>	47	
<u>Miscellaneous</u>	2	304
		749

(1) Local Government Financial Statistics, England and Wales.  
1950-1951.

## II The United States

There is no coherent American grant system. The federal-state grants are piecemeal and defy, to a considerable extent, our six desiderata set down below, and a fortiori defy the concept of economic equilibrium already outlined.

Before 1930, the federal subventions amounted to about \$100 million only, of which the highways formed about four-fifths.

The subsidies assumed more important proportions since 1935 when the Social Security Act provided for further aid in respect of old age, maternity and child welfare, and unemployment. (1)

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(1) Shere, Louis : "Some General Comments on Federal Grants." Bulletin of the National Tax Association. December, 1946.

Harris, Joseph P. : "The Future of Federal Grants-in-Aid." in The Annals of the American Academy of Political and Social Science, "Intergovernmental Relations in the United States." Philadelphia, 1940 P. 14

Bittermann, Henry J. : "State and Federal Grants-in-Aid." New York, 1938.

(1) Maxwell, James A. : "Federal Grants and the Business Cycle." National Bureau of Economic Research. New York, 1952.

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The percentage of federal grants in net state and local expenditures thus rose very much. During the period 1920-1933 it oscillated between 1.3 per cent and 3.3 per cent. Between 1934-1942 the percentage reached 20-40 per cent.

During the Second World War the federal grants declined in absolute amount as well as proportionately to net state and local expenditures. The percentage was as low as 9 in 1946.

The post-war trend, however, discloses a rise.

American Federal Grants

(millions of dollars) (1)

Year	Total Federal Grants	Grants as % of net state and local expenditures.
1920	76	2.0
1925	114	1.8
1930	113	1.3
1935	2,277	35.6
1940	2,401	32.0
1942	1,827	20.5
1943	1,293	14.4
1946	901	9.0
1947	1,678	12.4
1948	1,629	10.3

(1) Maxwell, James A: "Federal Grants and the Business Cycle."  
National Bureau of Economic Research. New York, 1952.  
P. 18.

Appraisal:

The American federal grants fail to account for state fiscal capacity and do not ensure the achievement of a national quantitative and qualitative minimum of services all over the different states, rich and poor.

1. State Fiscal Capacity: The matching basis, so pre-dominant in the regular federal grants, militate/ against the inter-state equalization of the fiscal <sup>pressure</sup> ~~residue~~ or of social utility (general welfare.) In fact, the uniform-ratio basis presupposes a certain economic and fiscal capacity. The upshot is that the under-endowed states are not able to benefit to the same extent as the wealthier states.

The grants should be based on some indice<sup>es</sup> of state fiscal potential, notably state per capita income. Subventions should thus vary in inverse proportion to state per capita income. If this relation is in the right direction in some states; it is in the wrong direction in many others. Subsidies are high while per capita income is high in Washington, Oregon, Nevada, Colorado, California. Subsidies are low when per capita income is low as in Mississippi, Louisiana, North Carolina, Alabama, Kentucky.

The American aid programme is thus far from being ~~differential or~~ equalizing.



Professor Maxwell measures the correlation between *income* and *grants* by Spearman's formula:

Total Federal aid.	+	.31
Employment security	+	.89
Public assistance	+	.41
Education	+	.01
Highways	-	.11
Health	-	.39

It appears that only the subsidies for public health can be considered as equalizing. Those for education are distorting. As for the public assistance grants, they are high for the high income states and are thus most disequalizing. The trouble is that the latter item in federal aid is the most important, being approximately half the total.

2. National Minimum Service Standard: This requirement is not fulfilled as the grants do not have a wide coverage and give disproportionate weight to the various services.

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(1) Maxwell, James A.: "The Fiscal Impact of Federalism in the United States."  
Cambridge, Massachusetts, 1946. PP. 397-403

The federal subsidies do not link federal-state and state-local expenditures in a rational scheme aiming at securing everywhere a minimum volume and standard of services.

3. Intergovernmental Fiscal Policy Contradictions: The principles governing the grants, especially the matching basis, do not militate in favour of counter-cyclical policy-framing on the state level. The states most adversely affected will not secure more benefit from the federal grant system relatively to the states less or least hit.

These grants, however, failed to achieve equalization of resources or to secure a minimum level of services all over the Dominion's provinces. The grants were limited in scope, intermittent in nature and based on the matching principle which presupposes a certain provincial

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(1) Meistrand, H.C. "The Cases of Provincial Subsidies." Papers and Proceedings of the Sixth Annual Meeting of the Canadian Political Science Association, May, 1934.  
Garrath, E.A. "Problems of the Canadian Federation." The Canadian Journal of Economics and Political Science, February, 1935. p.25

### III Canada

The Dominion grants, in their development, fall far short of achieving an all-provincial socio-economic equilibrium. This fact assumes great importance as Canada is constituted of wealthy industrial provinces besides poor agricultural provinces. The population and natural resources are unevenly distributed. The subsidies were, from the beginning, the fruit of dominion-provincial bargaining and inter-provincial strife.<sup>(1)</sup>

Apart from the early grants given in compensation for the loss of customs and excises, various conditional payments were made in 1913 for agricultural instruction. These were later extended to technical education on highways in 1919, old-age in 1928 and relief in 1930.

These grants, however, failed to achieve equalization of resources or to secure a minimum level of services all over the Dominion's provinces. The grants were limited in scope, intermittent in nature and based on the matching principle which presupposes a certain provincial

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(1) Keirstead, W.C. : "The Bases of Provincial Subsidies." Papers and Proceedings of the Sixth Annual Meeting of the Canadian Political Science Association. May, 1934.  
Carrothers, W.A. "Problems of the Canadian Federation." The Canadian Journal of Economics and Political Science. February, 1935. P.26

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fiscal potential. As conditional grants they failed because dominion control was resented. While the conditions could not be enforced the financial help could not be withdrawn.

The Royal Commission on Dominion-Provincial Relations recommended the achievement of an average level of public services at average tax rates. It advocated the resort to a national adjustment grant periodically revisable.<sup>(1)</sup>

The Second World War induced changes, not in conformity with the Commission's recommendations but in response to the needs of the war.

Compensation was given for the loss of personal and corporate income taxes to the provinces. They were based either on the provincial tax collections of 1940 or the difference between the cost of the province's debt service and the yield of its inheritance tax. The latter basis was selected by provinces which had no well developed income taxes such as Nova Scotia, New Brunswick, Saskatchewan, Prince Edward Island.

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(1) Royal Commission on Dominion-Provincial Relations.  
Book II. Recommendations. See also:

Maxwell, J.A. "Canadian Dominion-Provincial Relations."  
Quarterly Journal of Economics. August, 1941.



#### IV Australia.

The transfer payments from the Commonwealth Government to the various states fall under two main categories. In the first category, there is the relief provided to primary producers adversely affected by national economic and tariff policies. Besides, there are the payments for social services made to individuals in the different states.

The second category comprises the central financial assistance properly known as grants. (1)

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(1) Moffat, Robert E.: "Financial Relations Between The Australian Commonwealth and the Australian States." The Canadian Journal of Economics and Political Science. February, 1947. P.465

Greenwood, Gordon: "The Future of Australian Federalism." Melbourne, 1946.

Wood, G.L.: "The Future of Federal Aid." The Economic Record. December, 1945.

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Copland, D.B.: "Problems of Federal Finance and Federal Grants in Australia." Quarterly Journal of Economics, May 1937.

Copland, D.B. : "Financial Relations of the States and The Commonwealth of Australia." Economic Journal, 1927.

It is possible to distinguish three categories of central subsidies; they are connected with the Australian Loan Council, the Commonwealth Grants Commission and the compensation for state income taxation after their transfer to the national level. (1)

The Australian Loan Council was created in 1923 to control the public loans of both states and Commonwealth. According to the Financial Agreement of 1927, per capita fixed payments were made in contribution towards the interest on states' borrowing. In addition, contributions of varying proportions were made to the states' sinking funds.

It is to be noticed that the Loan Council should not provide loans on a competitive basis but ought to take in consideration the requirements of long-term national developmental programmes, counter-cyclical policies and the volume and conditions of the federal grants.

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(1) Between 1901-1910 the Commonwealth used to distribute 75% of the revenue from customs and excise and any surplus accruing on a per capita basis. From 1910-11 to 1927, there was a per capita payment of 25s. Moreover the federal government had to give financial assistance to states in extreme need which was actually the case with Western Australia since 1910 and Tasmania since 1912.

A further stream of financial help accrued to the states through the Commonwealth Grants Commission. This body, created in 1933, was intended to alleviate the impact of the Great Depression on the weaker states. It soon evolved into a "court of conciliation and arbitration." in financial matters, making annual "recommendations" for subsidies.

The Commission decided to provide grants on the basis of needs. The latter concept was interpreted in two different ways which are both unsatisfactory.

Until 1940-41, the subventions paid were those necessary to reduce the budget deficit per capita, in the under-endowed states, to the average deficit per capita in the wealthier states. The deficit had to be a "reasonable" one and the claimant states had to show that they levied "reasonably heavy taxes" and that they were "spending carefully." (1) Clearly, the over-standard states were not entitled to any assistance.

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(1) See the Reports of the Commonwealth Grants Commission.  
that adjustment and according to "the efficiency of state administration and the wisdom of state expenditure." This feature, especially useful with unconditional grants, should prove an inducement to the applicant states when framing their financial policies, to be more responsive

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Apart from the elaborate mathematical calculation involved, the subsidies were thus destined to prevent the bankruptcy of the states rather than to ensure a national minimum service standard or to cope with the marked inter-state discrepancies in financial resources.

The concept of "budgetary deficit" was later modified for <sup>the</sup> better. The grants now available are those "necessary to give standard budget position." They are further adjusted according to two bases, namely the burden of taxation within the applicant state and the level of that state's social services.

In other terms, the grant is higher in case the claimant state has a heavier fiscal burden than the average or when the state has a standard of social services which is lower comparatively to the average standard.

The formula, in its latest shape, marks an interesting improvement since it introduces some degree of flexibility in the amount of the grants and more balance in the level of taxation and social service expenditures between the under-endowed (or claimant) states and the wealthier (or non-claimant) states. Equally noticeable is the further adjustment made according to "the efficiency of state administration and the wisdom of state expenditure." This feature, especially useful with unconditional grants, should prove an inducement to the applicant states when framing their financial policies, to be more responsive



to the principles laid down by the Commission .

However, the system is not geared to a national policy. A "standard budget position" may be anything between a classical balanced budget and a full employment budget. All states, without exception, should be entitled to financial aid, not only according to their relative needs, so as to exhibit less discrepancies, but also in so far as their economic capacity or standard of services are not in line, quantitatively or qualitatively, with national developmental policies.

We may now turn to the subsidies paid in compensation for income taxation, individual or corporate, relinquished by the states.

According to the first agreement of 1942, the states were paid on the basis of the average revenue from their own former income taxation.

In 1946, the States Grants (Tax Reimbursement) Act renewed the previous agreement without time limit.<sup>(1)</sup>

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(1) At the end of seven years, revision is possible if requested by either the Commonwealth Government or the States.

During the two first years (1946/47 and 1947-48), the total compensation was fixed at £40 million. This guaranteed minimum was, in subsequent years, to be raised with the rise in the total population (six states) and further augmented by one-half of the percentage rise in average wages per person employed compared to the average wages in 1947.

More flexibility in the volume of federal aid is thus introduced.

The most interesting feature concerns the apportionment of the subventions between the various states. Between 1948-57 the distribution is to take place on the basis of 1946-47 to the extent of only 90 per cent of the total grant in the period 1948-49, and only 80 per cent in 1949-50 and so on till in 1956-57 the proportion of total grant apportionable according to the 1946-47 basis reaches only 10 per cent.

The remainder of the ~~total~~ federal subvention is to be allocated in proportion to the adjusted population of the states. This adjusted population is obtained by adding to the actual population four times the number of the child population between five and fifteen and multiplying the result by a certain fraction. This fraction is high if the proportion of the residents of the aided state, living in sparsely

populated areas, is high. The fraction is lower if a higher proportion of the state's residents is living in urban centres.

After 1957, the whole Commonwealth grant for the purposes of income tax compensation will be payable according to adjusted population.<sup>(1)</sup>

In other terms, the concept of compensation for revenue ceded will have disappeared by 1957 and replaced by a per capita basis.

In conclusion, the whole system of Australian Federal aid is essentially one of ad hoc payments, non-comprehensive in spatial or service coverage. True, if we consider the three sets of grants combined, it will be found that the per capita payments to the poorer or claimant states is higher than in the case of wealthier states. <sup>(2)</sup>

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(1) It is to be noticed that the compensation to any state is not to fall below the level of 1946-47.

(2) Moffat, R.E.: Op. cit.

However, the per capita grants, the fixed annual grants, the unconditional grants and other forms of un-coordinated assistance are all devices which clearly do not comply with the concept of pan-territorial socio-economic equilibrium <sup>and even fail to secure a national minimum standard of services all over the country</sup>. Such aids lack coherence and, as they are not integrated in any comprehensive logical scheme, they are incompatible with a national economy conducted on rational lines.

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